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IN THE

Supreme Court of the United States

ZURICH AMERICAN INSURANCE COMPANY,

Petitioner,

v.

LEXINGTON COAL COMPANY, LLC,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In order to encourage lenders, vendors, and other creditors to do business with companies in bankruptcy, facilitating reorganization and the preservation of businesses, the Bankruptcy Code provides that administrative expenses—claims to payment that arise during a bankruptcy case, including the "actual, necessary costs and expenses of preserving the [bankruptcy] estate," 11 U.S.C. §503(b)(1)(A)—are entitled to priority over the claims of other creditors, *see id.* §507(a). The questions presented are:

1. Whether the Sixth Circuit erred in holding that administrative-expense priority does not extend to *all* payments due under a contract entered or assumed by the debtor during a bankruptcy case—a holding in direct conflict with decisions of the First, Second, and Fourth Circuits.

2. Whether the Sixth Circuit erred in holding that a creditor's claim against a bankruptcy estate arises only when the creditor's right to payment accrues under state law, in agreement with the Third Circuit but in conflict with the Second, Fourth, Fifth, Ninth, Tenth, and Eleventh Circuits.

PARTIES TO THE PROCEEDINGS

Petitioner is Zurich American Insurance Company, the appellant below. Respondent is Lexington Coal Company, LLC, the appellee below.

CORPORATE DISCLOSURE STATEMENT

Petitioner Zurich American Insurance Company is a wholly-owned subsidiary of Zurich Holding Company of America, Inc., a Delaware corporation. Zurich Holding Company of America, Inc. is a 99.8711% owned subsidiary of Zurich Insurance Company, a Swiss corporation. Zurich Insurance Company is directly and indirectly owned by Zurich Financial Services, a Swiss corporation. Zurich Financial Services is the only publicly traded parent company, with a listing on the Swiss stock exchange, and a further trading of American Depositary Shares.

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ZURICH AMERICAN INSURANCE COMPANY,
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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

Zurich American Insurance Company respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit is reported at 536 F.3d 683 (6th Cir. 2008). App. 1a-2a. Its order denying rehearing is unreported. App. 69a-70a. The opinion of the United States District Court for the Eastern District of Kentucky is reported at 371 B.R. 210 (E.D. Ky. 2007). App. 3a-58a. The opinion of the United States Bankruptcy

Court for the Eastern District of Kentucky is reported at 343 B.R. 839 (Bankr. E.D. Ky. 2006). App. 59a-68a.

JURISDICTION

The Court of Appeals entered its judgment on August 13, 2008, and denied rehearing on January 8, 2009. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

The version of §101(5) of the Bankruptcy Code, 11 U.S.C. §101(5), applicable to this case provides in relevant part:

> "Claim" means—
>
> > (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured[.]

The version of §503(b) of the Bankruptcy Code, 11 U.S.C. §503(b), applicable to this case provides in relevant part:

> After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—
>
> > (1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case[.]

The version of §507(a) of the Bankruptcy Code, 11 U.S.C. §507(a), applicable to this case provides in relevant part:

(a) The following expenses and claims have priority in the following order:

(1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.[1]

STATEMENT

1. Bankruptcy has dual goals: to grant a debtor a fresh start, including where appropriate the opportunity to reorganize and thus preserve its business, and to apportion the debtor's property equitably among its creditors, in accordance with the statutory priorities established by the Bankruptcy Code. *See, e.g.*, *Central Va. Comm. Coll.* v. *Katz*, 546 U.S. 356, 363-364 (2006). To achieve those goals, the Bankruptcy Code provides that when a debtor commences a bankruptcy case, all of its property, with certain narrow exceptions, becomes part of the bankruptcy estate. 11 U.S.C. §541. The debtor's creditors may then assert claims against the estate. *See id.* §§501-503. When an eligible debtor sat-

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[1] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") amended each of these provisions. BAPCPA amended §101(5) by inserting the words "The term" before the word "claim." Pub. L. No. 109-8, §1201(2). It amended §503(b)(1)(A) to clarify that certain back-pay awards are entitled to administrative-expense priority. *Id.* §329. And it amended §507(a) to provide that certain domestic-support obligations have first priority, above administrative expenses. *Id.* §212. None of those amendments applies in cases, like this one, commenced prior to the enactment of BAPCPA. *Id.* §1501. Nor is any of these amendments material to any issue in this case. For clarity, this petition hereafter refers only to the version of the Bankruptcy Code applicable to this case.

isfies the requirements of the Code, it may obtain a discharge of the existing claims against it. *See id.* §727 (Chapter 7 cases); *id.*.§1141(d) (Chapter 11 cases).

The Bankruptcy Code contains an exceedingly broad definition of the "claims" that may be asserted (and potentially discharged) in bankruptcy: a "claim" includes any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. §101(5). As Congress explained when the Code was enacted, "[b]y this broadest possible definition," the Code "contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case." H.R. Rep. No. 95-595, at 309 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6266; *see also Pennsylvania Dep't of Public Welfare* v. *Davenport*, 495 U.S. 552, 558 (1990); *Johnson* v. *Home State Bank*, 501 U.S. 78, 83 (1991).

This case involves a special type of claim against the bankruptcy estate: an administrative-expense claim. Administrative expenses are obligations incurred by the debtor or bankruptcy trustee during the bankruptcy case. They include, for example: loans, leases, supply agreements, or other contracts enabling the debtor to continue its business while it is attempting to reorganize; wages paid by the business while in bankruptcy; and tort or environmental liabilities incurred through the debtor's operations while it is in bankruptcy. *See generally Reading Co.* v. *Brown*, 391 U.S. 471 (1968). As defined by the Bankruptcy Code, administrative expenses include all "actual, necessary costs and expenses of preserving the estate." 11 U.S.C. §503(b)(1)(A).

The Bankruptcy Code provides that administrative expenses receive priority over the claims of other creditors. 11 U.S.C. §507(a). Priority status is important to a creditor's recovery because the claims against a bankruptcy estate typically far outstrip the value of the debtor's assets. Creditors with high-priority claims may be paid in full, whereas those lower in the hierarchy will likely recover only pennies on the dollar, or nothing at all. Congress chose to grant administrative-expense claims priority to "provide an incentive for creditors and others to continue or commence doing business with an insolvent entity." 4 *Collier on Bankruptcy* ¶503.06[2] (15th rev. ed. 2008). Lenders, suppliers, and others considering dealing with a debtor will understandably be wary that credit they extend might not be repaid. This concern is allayed if, in the event "the debtor fails to rehabilitate itself and winds up in liquidation, they can move to the front of the distributive line, ahead of the debtor's pre-bankruptcy creditors." *In re Klein Sleep Prods., Inc.*, 78 F.3d 18, 20 (2d Cir. 1996). Without that assurance, a debtor would be unlikely to obtain credit except on the most onerous terms, and its prospects of continuing its business and emerging from bankruptcy would be severely limited.

2. Petitioner Zurich American Insurance Company ("Zurich") provided workers' compensation, automobile, and general liability insurance to a coal-mining company, Horizon Natural Resources, and its affiliates (collectively, "Horizon"), beginning in 1998. Workers' compensation insurance was essential to Horizon's business. Indeed, it was required by state law. App. 11a n.5; Ky. Rev. Stat. Ann. §342.340.

There are two principal varieties of workers' compensation insurance policies: "guaranteed-cost" policies, in which the insurer assumes all the risk of the

workers' compensation claims, and "loss-sensitive" policies, including deductible policies, in which the insured assumes a portion of the risk associated with each claim. Because the insured bears part of the risk, deductible policies generally have significantly lower premiums than guaranteed-cost policies, and a significantly lower overall cost even when the deductibles are taken into account. App. 8a-9a. In addition, the deductibles structure spreads out the insured's payments, providing a cash-flow advantage particularly helpful to debtors in bankruptcy.

The insurance policies Horizon purchased from Zurich were deductible policies, under which Zurich agreed to pay the full amount of the claims against Horizon up front, and then bill Horizon for the deductible. Thus, Horizon had two payment obligations under the policies: first, to pay premiums, and second, to reimburse Zurich for the deductibles Zurich advanced. Zurich, in turn, was obligated to pay workers' compensation claims asserted against Horizon arising from accidents or other occurrences during the period of insurance coverage, even if the resulting injuries did not manifest themselves for months or years after coverage ended. Because coal-mining is particularly likely to result in injuries, such as black-lung disease, that become manifest only after a long latency period, such future workers' compensation claims are a virtual certainty. As the district court recognized, the "practical realit[y]" is that "these deductible obligations will inevitably arise, and in large number," "reach[ing] well into the millions of dollars range." App. 28a n.17.

3. In November 2002, Horizon filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code. Zurich continued providing insurance coverage to Horizon while Horizon attempted to reorganize. In

September 2003, Horizon assumed the Zurich policies, with bankruptcy-court approval, pursuant to 11 U.S.C. §365. App. 13a-14a.[2] In June 2004, Zurich and Horizon negotiated a series of short-term extensions taking the policies through the end of September 2004. App. 15a.

Horizon's reorganization efforts were unsuccessful, and it decided to liquidate. In August 2004, it auctioned part of its business as a going concern and sold the rest of its assets to other buyers, including respondent Lexington Coal Company ("Lexington"). The bankruptcy court approved the sale and confirmed Horizon's plan of liquidation, and on September 30, 2004, Horizon closed the sale of its assets. Under the order confirming Horizon's plan, Horizon was deemed dissolved as of that date. Horizon's insurance coverage with Zurich had also expired by that date. App. 15a.

Zurich then filed an administrative-expense claim against the estate (within the period for doing so established by the plan). Zurich sought to collect the amount of the deductibles it would have to advance in the fu-

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[2] Section 365 permits a trustee or debtor-in-possession to assume or reject an "executory contract ... of the debtor," subject to the court's approval. If the debtor chooses to assume a contract, it "continue[s] to receive the benefits of [the contract], while also continuing to perform its obligations under" the contract. *N.C.P. Mktg. Group, Inc.* v. *BG Star Prods., Inc.*, No. 08-463, 2008 WL 4522334, at *1 (U.S. Oct. 6, 2008) (Kennedy, J., respecting the denial of certiorari). In that event, expenses incurred under the assumed contract are treated as administrative expenses, just as if the contract were entered into during the bankruptcy. *See, e.g.*, *NLRB* v. *Bildisco & Bildisco*, 465 U.S. 513, 531-532 (1984). If the debtor rejects the contract, it walks away from its obligations under the contract, and the counterparty receives a claim for damages against the estate. *See id.* at 531.

ture on claims covered by Horizon's now-expired insurance policies. Because the deductibles would be paid on workers' compensation claims that had not yet been made, Zurich's claim required estimation. The evidence Zurich presented as a basis for that estimation was an actuarial calculus called an "ultimate loss projection." Insurance companies prepare such actuarial reports for "the basic purpose of estimating future obligations in connection with insurance coverage." App. 18a. Zurich's net administrative-expense claim, based on its ultimate loss projection and subtracting payments and the value of collateral Zurich had received from Horizon, was approximately $14.5 million. App. 20a-21a.

Lexington objected to Zurich's claim, and the bankruptcy court held that the deductibles were not administrative expenses. It observed that the Sixth Circuit applies a two-part test to determine whether a claim represents the "actual, necessary costs and expenses of preserving the estate" under §503(b)(1)(A): first, the debt must have "arisen from a post-petition transaction with the debtor," and second, it must have "directly and substantially benefi[t]ed the estate." App. 63a. The court asserted that "[e]xpenses incurred post-confirmation are not entitled to administrative expense priority treatment," and that payments Horizon owed under the insurance policies thus "must actually be paid prior to confirmation in order to qualify as an administrative expense." App. 64a-65a.

4. The district court affirmed. In doing so, the court recognized that "it is undisputed that Zurich will be rightfully 'owed' any deductible obligations advanced under the Zurich Policies ... when they 'arise.'" App. 23a-24a. It also recognized that the insurance coverage Zurich provided was essential to Horizon's reorganization efforts:

> There can be no question that ... the insurance coverage provided by the Zurich Policies was critical to the Debtors' operations. Without the insurance provided by Zurich, the Debtors would have been unable to operate their business as a going concern both prior to and during the pendency of the bankruptcy.

App. 10a-11a.

The district court nevertheless held that the deductibles Horizon owed under the insurance policies were not administrative expenses and that Zurich was not entitled to receive payment for the deductibles from the bankruptcy estate. Instead, the court concluded that Zurich could recover the deductibles only from any dissolved entity that might remain after the bankruptcy. That is, while Zurich would remain liable for future claims against Horizon, it would never be repaid for the substantial deductibles that Horizon had promised to pay in return for the insurance it purchased.

In so holding, the district court examined both the language of §503(b)(1)(A) and the "benefit to the estate" test on which the bankruptcy court had relied. The court first held that Zurich's claim for deductibles was not an "actual" cost of preserving the estate because Horizon's state-law obligation to reimburse Zurich for the deductibles would not accrue until after the bankruptcy—after injured workers had made claims and Zurich had paid those claims. App. 27a-28a ("Zurich is only contractually obligated to pay the deductibles, and subsequently seek reimbursement, once the [workers' compensation] claims actually 'arise.' ").

The court next concluded that the deductibles were not "necessary" costs of preserving the estate because

Horizon would not become obligated to pay them until after it had dissolved. "The moment Zurich is contractually permitted to seek reimbursement from the Debtors for the advanced deductibles, the estate will have already dissolved and the Debtors will cease to exist. Consequently, payment of the claimed expenses will in no way act to preserve an estate when there is no estate to preserve." App. 29a.

For similar reasons, the district court concluded that Zurich's claim did not meet the "benefit to the estate" test. App. 30a-34a. It reasoned that because the insurance contract did not require the reimbursement of deductibles until after Zurich had advanced them, Horizon's "deductible obligations d[id] not even exist" until after Horizon's dissolution and thus the payment of the deductibles would not provide a direct and substantial benefit to the estate. App. 33a-34a. The court acknowledged Zurich's argument that its claim for deductibles arose *during* the bankruptcy because Horizon assumed the insurance policies, and the accidents or other occurrences giving rise to the workers' compensation claims necessarily took place, before the bankruptcy ended. But the court dismissed that argument, reasoning that it "does not alter the dispositive adjudication that the payment of the claimed expenses when they truly arise"—in the court's view, only after the bankruptcy's conclusion—"would not act to either preserve [or] benefit the estate." App. 40a. Because Zurich's claim for deductibles would not arise until after the bankruptcy, the court reasoned, it could not be an

administrative-expense claim that could be asserted in the bankruptcy.[3]

5. The Sixth Circuit affirmed in a published, *per curiam* opinion that adopted the district court's reasoning. App. 2a.

REASONS FOR GRANTING THE WRIT

The Sixth Circuit's decision conflicts with two lines of cases from other courts of appeals and with this Court's decision in *Reading Co.* v. *Brown*, 391 U.S. 471 (1968). *First*, the court's conclusion that a debtor's obligation to pay a creditor under a contract assumed during the bankruptcy does not benefit the estate—and is not an administrative expense—if the payment is not yet due at the time of confirmation conflicts with decisions of the First, Second, and Fourth Circuits, and rests on a premise rejected in *Reading*. *Second*, the court's conclusion that Zurich's claim did not arise until its right to payment accrued as a matter of state contract law exacerbated one of the most significant and deeply entrenched splits of authority in bankruptcy law: the well-established three-way division of authority regarding how to determine when a bankruptcy claim arises. Both questions are recurring, significant to debtors' ability to reorganize, and likely to be even

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[3] The district court refused to rest its decision on two of the grounds the bankruptcy court relied on. First, it rejected the bankruptcy court's conclusion that Zurich's claim was untimely, holding that Zurich had filed its claim before the bar date and nothing more was required. App. 51a-53a. Second, although the district court suggested that estimation might not be appropriate for an administrative-expense claim, it chose not to make that suggestion part of its holding. App. 44a-47a (discussing estimation in section entitled "Other (Non-Dispositive) Considerations").

more important in the near future, as the nation's economic crisis brings a wave of new bankruptcies.

I. THE SIXTH CIRCUIT'S HOLDING THAT FUTURE OBLIGATIONS UNDER A CONTRACT ASSUMED DURING BANKRUPTCY ARE NOT ADMINISTRATIVE EXPENSES CONFLICTS WITH DECISIONS OF OTHER CIRCUITS AND IS IN TENSION WITH THIS COURT'S PRECEDENT

A. The Sixth Circuit's Holding Conflicts With The Decisions Of Other Courts Of Appeals

The Sixth Circuit, adopting the district court's reasoning, held that Horizon's obligation to pay deductibles under the Zurich policies it assumed during its bankruptcy so that it could continue operating its business was not an "actual, necessary cost[] and expense[] of preserving the estate" under §503(b)(1)(A). The court reasoned that payment of the deductibles could not "preserve [the] estate" because Horizon would not become obligated to pay them until after the bankruptcy case had ended. App. 27a. Similarly, applying the "benefit to the estate" test that various courts have employed to determine whether a claim is entitled to administrative-expense priority, the court reasoned that "the payment of the deductibles, when and if they should arise ... does not provide a direct and substantial benefit to, nor act to preserve, a bankruptcy estate where there is no longer an estate to benefit." App. 33a.

That reasoning suffers from a fundamental flaw: it asks whether *payment of the deductibles* would preserve or benefit the estate, rather than asking whether the *insurance* Horizon received in return for agreeing to pay premiums and deductibles preserved or benefited the estate. The purpose of granting priority to administrative expenses is to induce providers of es-

sential funds, goods, and services—such as insurance—to continue doing business with a debtor. The Sixth Circuit accordingly erred by concluding that "the benefit [to the estate] should be measured" only when the payment would become due, App. 32a, rather than during the bankruptcy case, when Horizon was enabled to continue its business by the insurance Zurich provided.

Three other federal courts of appeals have addressed this precise question and reached the opposite conclusion. *See In re Hemingway Transp., Inc.*, 993 F.2d 915 (1st Cir. 1993); *In re Klein Sleep Prods., Inc.*, 78 F.3d 18 (2d Cir. 1996); *In re Merry-Go-Round Enters., Inc.*, 180 F.3d 149 (4th Cir. 1999). In concluding that claims arising from contracts and other obligations that entail future payments are entitled to administrative priority, those courts have properly focused on the benefit to the estate at the time the debtor entered into or assumed a contract, or incurred a liability, that obligated it to make future payments. They hold that if the consideration the estate received in return for its contractual obligations benefited the estate or was otherwise necessary to its preservation, then *all* the obligations the debtor undertook—including future payment obligations—are entitled to administrative-expense priority. Under the rule adopted by these courts of appeals, Zurich would have been entitled to payment of its claim for deductibles as an administrative expense.

The First Circuit reached this result in *Hemingway*, a case concerning liability for future environmental clean-up costs under the Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. §§9601-9657 ("CERCLA"). The debtor in that case, Hemingway, operated a trucking facility contaminated by leaking drums of hazardous substances. After Hemingway filed a Chapter 11 bankruptcy peti-

tion, a land developer, Juniper, purchased the facility for $1.6 million. *See* 993 F.2d at 919-920. The EPA ordered Juniper to remove the drums, and Juniper filed a claim against the Hemingway estate, seeking to recover its past and future clean-up costs as administrative expenses. *See id.* at 920.[4] The First Circuit held that Juniper's claim for future clean-up costs was entitled to administrative priority under §503(b)(1)(A), provided that it survived a provision of the Bankruptcy Code—immaterial to this case—that restricts a claimant's ability to recover on debts on which it is jointly liable with the debtor. *See id.* at 934, 936.[5] Thus, if Juniper was not jointly liable with the debtor for the clean-up costs under CERCLA, the First Circuit held, its "claim for past *and future* [clean-up] costs should be

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[4] Both the current owner of a contaminated facility and the entity that owned the facility at the time of hazardous waste disposal are potentially responsible parties under CERCLA. *See generally* 42 U.S.C. §9607(a). The EPA had designated both Juniper and Hemingway as potentially responsible parties. *See* 993 F.2d at 920 & n.2.

[5] Specifically, the Code requires disallowance of "any claim for ... contribution of an entity that is liable with the debtor on ... the claim of a creditor, to the extent that ... such claim for ... contribution is contingent as of the time of allowance or disallowance." 11 U.S.C. §502(e)(1)(B). Because the EPA had not yet ordered clean-up beyond its initial demand, Juniper's claim for future clean-up costs was "contingent" on such a future order from the EPA. 993 F.2d at 923. Thus, Juniper's claim would be barred by §502(e)(1)(B) if it were a claim for "contribution" on a debt on which Juniper and Hemingway were jointly liable to the EPA. If, on the other hand, Juniper could avoid liability under CERCLA—for example, by establishing that it was an "innocent landowner" who purchased the facility without notice that it was contaminated—Juniper would not be "liable with the debtor" and its claim for future clean-up costs would not be barred by §502(e)(1)(B).

estimated and allowed as administrative expenses entitled to priority." *Id.* at 934 (emphasis added).

In reaching that conclusion, the First Circuit began with the "benefit to the estate" test as first set out in *In re Mammoth Mart, Inc.*, 536 F.2d 950, 954 (1st Cir. 1976). Under that test, a claim is an "actual, necessary cost[] and expense[] of preserving the estate" under §503(b)(1)(A) if (1) the right to payment "arose from a postpetition [as opposed to pre-bankruptcy] transaction with the debtor," and (2) "the consideration supporting the right to payment was beneficial to the estate of the debtor." *Hemingway*, 993 F.2d at 929 (internal quotation marks omitted). Like Lexington here, the trustee in Hemingway argued that Juniper's future clean-up costs under CERCLA were not administrative expenses because Juniper's payment of those costs would not benefit the estate. *See id.* at 929-930. The First Circuit rejected that argument. In direct contradiction to the Sixth Circuit's reasoning below, the First Circuit held that, in determining whether Juniper's claim was an administrative expense, the relevant inquiry was not whether the *payment* of clean-up costs would benefit the estate, but whether the *consideration* Juniper had provided, and from which its claim ultimately arose—there, the $1.6 million purchase price Juniper had paid for the facility—benefited the estate. "Obviously," the court observed, "this substantial infusion of cash benefited the chapter 11 rehabilitation effort. Thus, the $1.6 million in purchase monies constituted the requisite baseline 'consideration' for Juniper's right to contribution; and [clean-up] costs subsequently incurred by Juniper a mere maturation of that right, immaterial for *Mammoth Mart* purposes." *Id.* at 930.

Zurich would have prevailed under this analysis. The workers' compensation and other insurance cover-

age it provided to Horizon during the bankruptcy unquestionably benefited the estate—as the court itself acknowledged. App. 10a-11a ("There can be no question that ... the insurance coverage provided by the Zurich Policies was critical to the Debtors' operations. Without [it], the Debtors would have been unable to operate their business as a going concern both prior to and during the pendency of the bankruptcy."). As in *Hemingway*, the expenses for which Zurich seeks payment in the bankruptcy—reimbursement of the deductibles it will have to advance under the insurance agreements—are a "mere maturation of [its] right" to be paid in return for the valuable consideration it provided to the debtor's estate. 993 F.2d at 930. The decision below squarely conflicts with *Hemingway*.[6]

The Second and Fourth Circuits have also allowed the recovery of future payment obligations as administrative expenses, likewise reasoning that the proper focus of the "benefit" analysis is the consideration the debtor received in return for entering into the contract giving rise to the future payment obligations. In the Fourth Circuit's decision in *Merry-Go-Round*, the debtor entered into a ten-year lease for retail store

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[6] Not only did the First Circuit hold that Juniper's claim for future clean-up costs could be allowed as an administrative expense, it recognized that the forward-looking nature of the claim meant that Juniper's clean-up costs would have to be estimated. *See* 993 F.2d at 934 & n.25 ("Juniper's claim for ... future [clean-up] costs should be estimated and allowed as administrative expenses entitled to priority."). Thus, had the Sixth Circuit squarely held, rather than endorsing the district court's "non-dispositive" suggestion, that estimation is unavailable for an administrative expense claim under §503(b)(1)(A), App. 44a-47a, it would have created a circuit split on that issue too.

space during its Chapter 11 bankruptcy case. *See* 180 F.3d at 152. Merry-Go-Round's reorganization efforts failed, and the case was converted to Chapter 7. The Chapter 7 trustee subsequently rejected the lease and returned the premises to the landlord, giving rise to a contractual claim for the future rent for the remainder of the lease. *See id.* at 152-154. The landlord filed a claim seeking administrative-expense treatment for the future rent due under the lease. The trustee opposed allowance of the claim on grounds similar to those advanced by Lexington here, arguing that it did not represent an "actual, necessary cost and expense of preserving the estate" under §503(b)(1)(A) because once the leased premises were vacated, the estate no longer made any actual use of them and the lease was no longer necessary to the estate. *See id.* at 156-157.

The Fourth Circuit rejected those arguments and held "as a matter of law" that the landlord's claim for future rent was an administrative expense. 180 F.3d at 155. It reasoned—in direct contradiction to the Sixth Circuit here—that the future rent was an "actual" expense of preserving the estate because it arose out of a transaction between the debtor and the landlord during the bankruptcy. *Id.* at 157. Moreover, the future rent was a "necessary" expense of preserving the estate because, before conversion to Chapter 7, the lease clearly was beneficial to the debtor, permitting it to continue operating its business. *Id.* The court explained that because landlords would refuse to enter leases with tenants in bankruptcy without some assurance that the rent obligations would be paid in full, "the future rent ... was an actual and necessary expense [of] preserving the estate" and thus entitled to administrative priority. *Id.* at 158.

The Second Circuit has similarly held that future rent owed under a lease assumed and then rejected during a bankruptcy case must be treated as an administrative expense. In *Klein Sleep*, the debtor assumed a long-term retail lease so that it could continue to operate its business while it tried to reorganize. After its attempt to reorganize failed, the case was converted to Chapter 7. The newly-appointed Chapter 7 trustee rejected the lease and returned the premises to the landlord, triggering the lease's provision for payment of future rent as damages. *See* 78 F.3d at 20-21. The landlord sought administrative-expense treatment for its claim for future rent. Both the bankruptcy and district courts reasoned, like the Sixth Circuit here, that the future rent was not an administrative expense because its payment would confer no benefit on the estate. *See id.* at 22.

The Second Circuit reversed, holding that "a trustee or debtor-in-possession's assumption of an unexpired lease transforms *all* liability under the lease ... into administrative expenses." 78 F.3d at 22 (emphasis in original). The court explained that the lower courts' analysis relied on "an unduly narrow view of the benefit conferred on an estate when a [debtor] assumes an unexpired lease." *Id.* at 24. When the debtor assumed the lease, the court held, it obtained the rights to present and future possession of the premises, which "had a present value at the time of assumption. Acquisition of those rights clearly constituted a benefit to the estate even if, later, the benefit turned to dust." *Id.* at 26. A contrary holding, the court noted, "would mean that any post-bankruptcy contract, entered into for the benefit of a bankrupt's estate, would cease to be entitled to priority the moment the deal turned sour." *Id.* Such a result would contravene the purpose of the ad-

ministrative-expense provisions: to encourage suppliers of essential credit, goods, and services to undertake the risk of dealing with a company in bankruptcy.[7]

The reasoning and result of the Sixth Circuit in this case squarely contradict the Fourth Circuit's decision in *Merry-Go-Round* and the Second Circuit's decision in *Klein Sleep*. Under the Fourth Circuit's reasoning in *Merry-Go-Round*, Zurich's claim for future deductibles was "actual" within the meaning of §503(b)(1)(A) because it stemmed from a transaction with the bankruptcy estate, and it was "necessary" because it was an obligation Horizon undertook in return for the provision of insurance it needed to operate its business. *See* 180 F.3d at 157. And, as the Second Circuit explained in *Klein Sleep*, asking whether the payment of future obligations under a contract benefits the estate—as the Sixth Circuit did here—takes "an unduly narrow view of the benefit conferred on an estate" when a debtor enters into or assumes a contract for necessary goods or services during a bankruptcy. 78 F.3d at 24. As in *Klein Sleep*, "[a]cquisition of th[e] rights [to insurance] clearly constituted a benefit to the estate even if, later,

[7] *See also In re Frontier Props., Inc.*, 979 F.2d 1358, 1367 (9th Cir. 1992) (when a debtor assumes and then rejects an executory contract post-petition, "all of the liabilities flowing from that rejection are entitled to priority as administrative expenses of the estate"). Following *Klein Sleep* and *Frontier*, BAPCPA amended §503 by adding paragraph (b)(7), which caps the amount of rent entitled to administrative-expense treatment for a nonresidential real-property lease assumed, then rejected, under §365. Pub. L. No. 109-8, §445. The imposition of the cap, however, did not change the holding of those cases relevant here: that such future rent payments are administrative expenses.

the benefit turned to dust" because Horizon's reorganization effort failed. *Id.* at 26.

The Sixth Circuit's failure to recognize these principles, and its clear departure from the governing legal rule in the First, Second, and Fourth Circuits, warrants this Court's review.

B. The Sixth Circuit's Decision Relies On A Premise Rejected By This Court's Precedent

The Sixth Circuit's decision also misapprehends basic principles articulated by this Court in the leading case construing the administrative-expense provision. In *Reading Co.* v. *Brown*, 391 U.S. 471 (1968), this Court construed the predecessor to §503(b)(1)(A) under the Bankruptcy Act of 1898, which similarly granted administrative priority to "the actual and necessary costs and expenses of preserving the estate." *Id.* at 475. The Court was faced with the question whether a tort claim against the debtor arising during a bankruptcy met that definition; the claimants were building owners whose properties had been damaged by a fire caused by the negligence of the bankrupt's receiver. *See id.* at 473. The Court held that those claims did meet the definition, reasoning that " 'actual and necessary costs' should include costs ordinarily incident to operation of a business, and not be limited to costs without which rehabilitation would be impossible." *Id.* at 483. Accordingly, because the tort claim was the result of the debtor's operation of its business during the bankruptcy, it was entitled to administrative priority.

Reading thus expressly rejected one of the key premises underlying the Sixth Circuit's decision: the notion that a *payment* must benefit the estate to be entitled to administrative priority. Instead, the proper inquiry is whether the debt was incurred through the

operation of the debtor's business, as a result of its efforts to continue the business as a going concern (either for reorganization or sale to the highest bidder). That is unquestionably true here: the insurance coverage Zurich provided permitted the debtor to continue operating as it sought to reorganize, to the benefit of the estate and its creditors. *See, e.g.*, App. 10a-11a (without the Zurich policies, Horizon "would have been unable to operate ... as a going concern ... during the pendency of the bankruptcy"). Indeed, *Reading* specifically noted that "[i]t is of course obvious that proper insurance premiums must be given priority, else insurance could not be obtained." 391 U.S. at 483. Had the Sixth Circuit properly applied the legal principles underlying *Reading*, it would have recognized that the insurance provided by Zurich benefited the estate, and that the obligations owed under the insurance contract thus were "actual, necessary costs and expenses of preserving the estate."

II. The Sixth Circuit's Decision Exacerbates The Entrenched Split Of Authority Regarding When A Claim Against A Bankruptcy Estate Arises

The Sixth Circuit's decision rested in significant part on the conclusion that Zurich's claim for reimbursement for deductibles under its policies would not "arise" until Horizon's obligation to pay the deductibles accrued as a matter of state contract law. The district court acknowledged that Zurich was entitled to reimbursement of the deductibles under the insurance policies. App. 23a-24a ("[I]t is undisputed that Zurich will be rightfully 'owed' any deductible obligations advanced under the Zurich Policies (pursuant to the Deductible Agreements) when they 'arise[.]' "). It emphasized, however, that the insurance contract did not re-

quire Horizon to pay Zurich for the deductibles until Zurich first paid the claims against Horizon, and concluded that such "expenses that arise and are incurred post-confirmation should [not] relate back to the underlying contractual arrangement during the bankruptcy." App. 33a. Indeed, the court held that "the deductible obligations do not even exist until [workers' compensation] claims arise whereby Zurich must advance payment." App. 33a-34a.

Accordingly, the court rejected Zurich's argument that because its claim stemmed from events during the bankruptcy—Horizon's decision to assume the insurance policies, as well as the occurrences that would later give rise to injuries and workers' compensation claims—it was entitled to an administrative-expense claim against the estate. App. 33a-34a.[8] Rather, finding that Zurich's claim did not yet exist and thus could not be asserted as an administrative-expense claim in the bankruptcy, the court relegated Zurich to whatever recovery it might be able to obtain "as a creditor of the dissolved estate"—that is, none. App. 24a.

In so holding, the Sixth Circuit took sides in an entrenched three-way circuit split regarding one of the most important and fundamental questions in bankruptcy law: when does a bankruptcy claim arise? The

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[8] Even if some of the deductibles related to accidents or occurrences that took place during the period of insurance coverage prior to bankruptcy, Horizon's assumption of the insurance policies in bankruptcy rendered all obligations under those policies administrative expenses arising during the bankruptcy case. *See* 4 *Collier on Bankruptcy* ¶503.06[6][b] ("[A]ssumption of [a] contract ... turn[s] a prepetition liability into a postpetition liability," "entitled to administrative expense priority.").

answer to that question plays a crucial role in a claimant's recovery. If a claim arises before the filing of the bankruptcy petition, it receives no special priority, unless it falls into one of the narrow categories set out in §507. If such a pre-bankruptcy claim is unsecured, it will likely receive only cents on the dollar, if it is paid at all. If, on the other hand, a claim arises after the filing of the bankruptcy petition and during the bankruptcy, it will generally be an administrative expense entitled to priority over the claims of pre-bankruptcy creditors. Such administrative-expense claimants will typically receive a far higher proportion of the amount they are owed. Finally, if a claim does not arise until after the bankruptcy case is concluded, it is not entitled to payment in the bankruptcy at all (nor is it discharged in bankruptcy). In that case, if the debtor succeeds in reorganizing, the claim may be asserted against the reorganized entity. In the common event that the debtor liquidates—as occurred here—the claimant will almost certainly recover nothing: "its right to recover exists in theory but is not enforceable in practice." *Reading*, 391 U.S. at 478.

The courts of appeals have adopted at least three different approaches to determining when a bankruptcy claim arises. The Sixth Circuit's approach—concluding that a "claim" for bankruptcy purposes arises when the creditor's right to payment accrues under state law—had previously been adopted by the Third Circuit. *See In re M. Frenville Co.*, 744 F.2d 332 (3d Cir. 1984). But six other circuits have rejected the *Frenville* approach, instead adopting analyses falling into two broad categories: the Fourth and Tenth Circuits have adopted the so-called "conduct test," under which a bankruptcy claim arises when the conduct giving rise to the claim occurs, and the Second, Fifth,

Ninth, and Eleventh Circuits have adopted either the "relationship" test, under which a claim arises when the debtor's conduct giving rise to the claim has occurred and the debtor and creditor have formed a relationship, or a variant known as the "fair contemplation" test, which adds the nuance that the claim must be within the "fair contemplation" of the parties before it can be asserted (or discharged) in the bankruptcy.

Frenville itself turned on whether the claim at issue arose before or after the filing of the bankruptcy petition. *See* 744 F.2d at 333. An accounting firm that the debtors had engaged as an auditor was sued by a group of banks for negligently preparing the debtors' financial statements. *See id.* The accounting firm wished to obtain indemnification or contribution from the debtors via a third-party complaint, which was permissible under the automatic-stay provision, 11 U.S.C. §362(a)(1), only if the firm's claim arose before the filing of the bankruptcy petition. *See* 744 F.2d at 334. The court acknowledged that "the debtor[s'] acts which form the basis of [the] suit"—preparation of the financial statements—"occurred pre-petition," but nevertheless, looking to New York law, held that the accounting firm's claim for contribution or indemnification from the debtor arose only post-petition, once it had been sued by the banks. *Id.* at 334, 337 ("[T]he threshold question of when a right to payment arises ... 'is to be determined by reference to state law.' " (citation omitted)). The *Frenville* decision has been widely criticized, but the Third Circuit has repeatedly announced its intention to adhere to it. *See, e.g., Jones* v. *Chemetron Corp.*, 212 F.3d 199, 206 (3d Cir. 2000) ("We are cognizant of

the criticism the *Frenville* decision has engendered, but it remains the law of this circuit." (footnote omitted)).[9]

Other than the Sixth Circuit, every court of appeals to consider the issue has rejected *Frenville*'s focus on the time at which a right to payment accrues under state law, noting the breadth of the definition of "claim" under the Bankruptcy Code and the undesirable consequences that may follow from an overly restrictive reading of that definition. The Fourth Circuit and Tenth Circuit have adopted the so-called "conduct" test, under which a claim arises when the conduct giv-

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[9] Confirming the entrenched nature of the split, the Sixth Circuit had previously endorsed the Third Circuit's *Frenville* line of authority in *CPT Holdings, Inc.* v. *Industrial & Allied Employees Union Pension Plan*, 162 F.3d 405 (6th Cir. 1998). *CPT* held that a pension plan's claim against a debtor employer for withdrawal liability under ERISA arose only when the plan acquired a cause of action under ERISA after the bankruptcy, splitting with other cases that had held that a contingent bankruptcy claim for withdrawal liability existed prior to the accrual of an ERISA cause of action. *See id.* at 408-409. The Sixth Circuit reasoned that "[i]t is not enough ... to look at the broad definition of 'claim' in the Bankruptcy Code." *Id.* at 409. Rather, "[t]he relevant non-bankruptcy law must be examined" to determine when a "right to payment" arises. *Id.* In so holding, the Sixth Circuit chose to follow the Third Circuit's decision in *In re Remington Rand Corp.*, 836 F.2d 825 (3d Cir. 1988), which itself relied on *Frenville* to hold that "the existence of a valid claim" under bankruptcy law depends on whether a right to payment exists under the non-bankruptcy law that governs the claim. *See id.* at 830. Although, prior to *CPT* and this case, the Sixth Circuit had stated that "the proper standard for determining [a] claim's administrative priority looks to when the acts giving rise to a liability took place, not when they accrued," *In re Sunarhauserman, Inc.*, 126 F.3d 811, 818 (6th Cir. 1997), that case did not discuss the split of authority or the *Frenville* reasoning later adopted by *CPT* and applied by the court in this case.

ing rise to the claim occurred. The Fourth Circuit first adopted that analysis in the bankruptcy of A.H. Robins, the manufacturer of the Dalkon Shield intrauterine device. *See Grady* v. *A.H. Robins Co.*, 839 F.2d 198, 201 (4th Cir. 1988) (expressly rejecting the reasoning of *Frenville* and concluding that a claimant who had a Dalkon Shield inserted before the bankruptcy petition had a "claim" for purposes of the automatic-stay provisions even if injury would not manifest itself until post-petition), *aff'g* 63 B.R. 986 (Bankr. E.D. Va. 1986) (holding that a "claim" arises at the "time when the acts giving rise to the alleged liability were performed"). The Fourth Circuit has subsequently applied that analysis in other contexts. *See Butler* v. *Nationsbank, N.A.*, 58 F.3d 1022 (4th Cir. 1995). *Butler* concerned a bank's claim to recover on a fraudulently endorsed check. The debtor had deposited the check before filing his bankruptcy petition. The court held that it was that underlying act—and not the bank's post-petition awareness of the forgery and efforts to recover the funds—that gave rise to the claim. *See id.* at 1029 (expressly refusing to follow *Frenville*, and concluding that the bank "had a claim as soon as [the debtor] deposited the fraudulently endorsed check," even though recovery "was contingent upon the receipt of notice of the forgery").

The Tenth Circuit has similarly held that a malpractice claim arises on the date the underlying conduct occurred, not on the date a cause of action accrued under state law. *See In re Parker*, 313 F.3d 1267, 1269 (10th Cir. 2002) (describing "conduct theory" as "more in tune with the plain language and the policy underlying the Bankruptcy Code"). The Tenth Circuit likewise expressly rejected the *Frenville* approach, approvingly citing the Fourth Circuit's observation that " 'the legis-

lative history shows that Congress intended that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in bankruptcy.' " *Parker*, 313 F.3d at 1269 (quoting *A.H. Robins*, 839 F.2d at 202).

Four other courts of appeals have likewise rejected *Frenville*, but have adopted analyses under which a claim arises either when a "relationship" is formed between the debtor and the claimant or when the claim can be said to be within the "fair contemplation" of the parties prior to the bankruptcy. In *In re Chateaugay Corp.*, 944 F.2d 997 (2d Cir. 1991), the Second Circuit considered the extent to which future clean-up costs that might be expended by the EPA under CERCLA based on the debtor's release of hazardous waste prior to bankruptcy constituted "claims" dischargeable in the bankruptcy. The court reviewed both the approach under which a "claim" exists only once a state-law right to payment has accrued, and the approach under which a "claim" exists as soon as the pre-bankruptcy conduct on which it was based occurred, and adopted a middle ground, holding that at a minimum the debtor and creditor must have a "relationship," such as the relationship between a regulated entity and regulator, at the time of filing the petition. *See id.* at 1001-1005. Applying that test, the court found that the EPA had a claim in the bankruptcy for all future clean-up costs arising from the debtor's pre-bankruptcy discharge of hazardous waste. *See id.* at 1005.

The Fifth Circuit applied a similar "relationship" test in *Lemelle* v. *Universal Manufacturing Corp.*, 18 F.3d 1268 (5th Cir. 1994). The plaintiff in that case sought to go forward with a wrongful-death claim against the manufacturer of an allegedly defective mobile home that had burned down. The defendant ar-

gued that the plaintiff's claim had been discharged in its bankruptcy, which occurred after it manufactured and distributed the mobile home but before the fire. The Fifth Circuit noted the three conflicting lines of authority, *see id.* at 1275-1276, and concluded that the absence of any "pre-petition contact, privity, or other relationship" between the manufacturer and the plaintiff precluded a finding that her claim arose prior to discharge, *id.* at 1277.

In *In re Piper Aircraft Corp.*, 58 F.3d 1573 (11th Cir. 1995), the Eleventh Circuit addressed the question whether Piper, an aircraft manufacturer, could discharge in its bankruptcy all claims that might be asserted in the future by any person arising out of aircraft manufactured or distributed by Piper before bankruptcy. The court acknowledged the three-way split on the issue, and declined to adopt either the *Frenville* "state law claim theory," *id.* at 1576 n.2, or the Fourth Circuit's "conduct" test, *id.* at 1576-1577, which might have supported the broad relief sought by the debtor. Rather, it held that "[t]he debtor's prepetition conduct gives rise to a claim to be administered in a case only if there is a relationship established before confirmation between an identifiable claimant ... and [the debtor's] prepetition conduct." *Id.* at 1577.

Finally, in another environmental clean-up case, the Ninth Circuit adopted a more restrictive variant of the "relationship" test often called the "fair contemplation" test, holding that "all future ... cost[s] based on pre-petition conduct that can be fairly contemplated by the parties at the time of [the] bankruptcy" are "claims" under the Bankruptcy Code. *In re Jensen*, 995 F.2d 925, 930 (9th Cir. 1993) (internal quotation marks omitted). The court reviewed and rejected both the broad "conduct" test and "*Frenville*'s 'right of payment'

theory," noting that the latter "is widely criticized outside the Third Circuit, at least in part because it would appear to excise 'contingent' and 'unmatured' claims from §101(5)(A)'s list." *Id.* at 929-930 (citation omitted).

Under any of the conduct, relationship, or fair contemplation tests, Zurich would have had a claim for deductibles that arose during Horizon's bankruptcy, when Horizon assumed the insurance policies that obligated it to pay those deductibles. By the conclusion of the bankruptcy, the contract had been assumed; the period of insurance coverage had expired; and Horizon unquestionably understood that it was liable for the deductibles associated with workers' compensation claims that would be asserted in the future arising out of that period of coverage. That Zurich's claim was dependent on future workers' compensation claims being asserted and paid makes no difference. Under the plain language of §101(5) of the Bankruptcy Code, as interpreted by a majority of circuits, it was nonetheless a "claim" in the bankruptcy.

By holding, to the contrary, that Zurich had no claim that could be asserted in the bankruptcy case because its contractual right to payment had not yet accrued, the Sixth Circuit aligned itself with the Third Circuit and against the six courts of appeals that have rejected the Third Circuit's approach. It thus exacerbated one of the most significant splits of authority in bankruptcy law, on an issue of central importance to the effective and uniform administration of the bankruptcy laws. That issue unquestionably merits this Court's review.

III. The Decision Below Was Incorrect And Threatens Debtors' Ability To Reorganize

The decision below marks a radical departure from the settled understanding of §503(b)(1)(A), under which a claimant who entered into a contract with a debtor during the bankruptcy case (or whose pre-bankruptcy contract the debtor assumed) is entitled to administrative priority for *all* payments due to it under that contract. *See, e.g., Bildisco*, 465 U.S. at 531 ("If the debtor-in-possession elects ... to assume [an] executory contract ... it assumes the contract *cum onere*, and the expenses and liabilities incurred may be treated as administrative expenses, which are afforded the highest priority on the debtor's estate" (citations omitted)); 2 *Collier on Bankruptcy* ¶365.09[5] (when a pre-bankruptcy contract is assumed and then rejected, "[o]ne might argue that if the estate gets no benefit from the breach, there is no basis for administrative priority.... The better approach, however, is to recognize that the estate receives the benefit of the assumed contract ... and takes that contract *cum onere*. Therefore, any damages flowing from the breach of a previously assumed contract should be considered first priority administrative expenses.").

Horizon unquestionably benefited from the insurance coverage Zurich provided it during the bankruptcy. App. 10a-11a ("There can be no question that ... the insurance coverage provided by the Zurich Policies was critical to [Horizon's] operations. Without the insurance provided by Zurich, [Horizon] would have been unable to operate [its] business as a going concern ... during the pendency of the bankruptcy."); App. 11a n.5 (because state law required Horizon to carry workers' compensation coverage, "the insurance policies themselves necessarily constituted a significant benefit

to the estate in that the coverage allowed [Horizon's] business to operate"). The insurance contracts it entered with Zurich obligated Horizon to reimburse Zurich for the advanced deductibles. And a debtor's obligations under a contract necessary to operate its business are *ipso facto* actual, necessary costs of preserving the estate.

The Sixth Circuit's contrary decision is an unduly narrow interpretation of the Bankruptcy Code's administrative-expense provisions. If left uncorrected, it will significantly impair financially distressed companies' ability to reorganize. Reorganization depends critically on the willingness of lenders, suppliers, landlords, insurers, and other parties to provide the debtor with needed credit, goods, and services during the bankruptcy, so that it can preserve and potentially rehabilitate its business. Such parties will have good reason to be wary of providing credit to an entity in bankruptcy, whose ability to pay is necessarily in doubt. The Bankruptcy Code therefore grants administrative-expense claims priority over claims of other creditors, assuring such parties that if they do business with a company in bankruptcy, they will be paid amounts due to them in full. The Sixth Circuit's decision undermines that assurance, imposing on parties contracting with debtors the risk that, if the debtor's reorganization efforts fail, they will be left unpaid. Such uncertainty will seriously threaten debtors' ability to obtain the goods and services they need to reorganize.

This risk is particularly acute for debtors that require any type of liability insurance. Insurers will be unwilling to offer debtors the type of insurance policies they are most likely to afford—policies requiring the payment of deductibles. *Cf. In re Ionosphere Clubs, Inc.*, 85 F.3d 992, 994 (2d Cir. 1996) (noting that no in-

surance company was willing to offer guaranteed-cost workers' compensation coverage to financially distressed airline). As this Court explained in *Reading*, "[i]t is of course obvious that proper insurance premiums must be given priority, else insurance could not be obtained," 391 U.S. at 483, and insurance is necessary to every debtor's business. Without affordable insurance, many Chapter 11 debtors will have no opportunity to attempt reorganization, and will be forced to liquidate.

Indeed, even debtors' ability to liquidate in the fashion most beneficial to their creditors will be impaired. Deprived of the opportunity to operate their businesses as going concerns while seeking the highest bidder for those businesses, debtors may be forced instead to sell their assets at "fire sale" prices, dramatically reducing the value of the estate and the distributions to creditors.[10]

The Sixth Circuit's narrow construction of the Bankruptcy Code's expansive definition of "claim" likewise presents an issue of the greatest significance

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[10] The Sixth Circuit's construction of the administrative-expense provisions is also likely to have serious repercussions for states that permit employers to self-insure their workers' compensation obligations. Under these programs, the employer pays benefits directly to employees. *See, e.g.*, Mich. Admin. Code, R. 408.43c(1). Many states have established state guaranty funds, from which an injured employee can collect if insolvency prevents the employer from paying the claim. *See, e.g.*, Mich. Comp. Laws Serv. §§418.501(1), 418.537(1). The Sixth Circuit's decision raises the prospect that state funds that pay the workers' compensation claims of insolvent employers will not be able to recover those payments from the employers' estates, and that the shortfall will devolve on either the state or the injured employees.

to the administration of bankruptcies. The division of authority on that most basic of questions seriously impairs the uniformity that bankruptcy law requires. A claimant like Zurich, who in the great majority of circuits would be an administrative claimant entitled to priority over the claims of other creditors, in the Third Circuit or Sixth Circuit has no claim in the bankruptcy case at all. Likewise, a claimant who holds a contingent claim under the relationship test prior to bankruptcy, but whose right to payment accrues under state law only during the bankruptcy, in the majority of circuits would be a pre-bankruptcy creditor entitled only to share *pro rata* with other like creditors, but in the Third Circuit or Sixth Circuit would be entitled to administrative priority. That outcome upends the goals of the administrative priority provisions: to encourage dealings with entities during their bankruptcy cases. It also has profound implications for any bankruptcy—most obviously, those involving tort and environmental liabilities—in which there are likely to be claimants harmed by the debtor's pre-bankruptcy conduct, but whose injury becomes manifest only later.

The prompt resolution of the questions presented is particularly critical now, when the global economic crisis has left many of the nation's leading industrial companies on the verge of bankruptcy. Many economic forecasters predict a substantial surge in corporate bankruptcy filings, extending well into 2010.[11] The live-

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[11] *See, e.g.*, Siew, *US Company Bankruptcies May Top 100 Next Year*, Reuters (July 31, 2008) (bankruptcies of public companies with more than $100 million in assets "may soar to more than 100 in 2009"), *available at* www.reuters.com; Bain & Company, *Bankruptcies of Large U.S. Companies To Extend Into 2010* (Dec. 1, 2008) (similar projection for 2010), *available at* www.bain.com.

lihoods of many workers, as well as the success of those who do business with these troubled companies, will turn on whether their attempts to reorganize succeed. The Sixth Circuit's decision is a substantial impediment to those efforts. It warrants this Court's review.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APRIL 2009

APPENDICES

APPENDIX A

In re HNRC DISSOLUTION COMPANY, formerly known as Horizon Natural Resources Company, et al., Debtors.

Zurich American Insurance Company, Appellant,

v.

Lexington Coal Co., LLC, Appellee.

No. 07-5894.

United States Court of Appeals,
Sixth Circuit.

Argued: July 29, 2008.
Decided and Filed: Aug. 13, 2008.

Appeal from the United States District Court for the Eastern District of Kentucky at Ashland. No. 06-00104—David L. Bunning, District Judge.

Before: ROGERS and McKEAGUE, Circuit Judges; ADAMS, District Judge.*

OPINION

PER CURIAM.

Zurich American Insurance Co. ("Zurich") provided insurance coverage to Horizon Natural Resources Co., et al., ("the Debtors") during the pendency of the Debtors' Chapter 11 bankruptcy proceedings. The policies issued to the Debtors were "deductible policies," mean-

* The Honorable John R. Adams, United States District Judge for the Northern District of Ohio, sitting by designation.

ing that Zurich would pay the entirety of any claims made and would later seek reimbursement from the Debtors for the deductible portion. After confirmation of the Debtors' plans, but before the expiration of the date set for the filing of administrative expense claims, Zurich filed an administrative expense claim. Zurich's administrative expense claim seeks payment of $14,593,567.79, which is an actuarial estimate of the deductible portion of the claims that Zurich believes it will pay in the future for injuries that occurred during the coverage period but were not the subject of insurance claims until after confirmation of the Debtors' plans. Both the bankruptcy court and the district court denied Zurich's administrative expense claim, holding that it does not constitute an "actual, necessary cost[ ] and expense[ ] of preserving the estate" as is required by 11 U.S.C. § 503(b)(1)(A).

On appeal to this court, Zurich argues that the bankruptcy court and the district court misinterpreted 11 U.S.C. § 503(b)(1)(A). Furthermore, Zurich argues that the lower courts should have permitted the estimation of Zurich's administrative expense claim under 11 U.S.C. § 502(c). We find no merit in Zurich's arguments. Because it would be difficult for us to add anything of substance to the district court's comprehensive and well-reasoned opinion, we **AFFIRM** for the reasons stated by Judge David L. Bunning in *Zurich Am. Ins. Co. v. Lexington Coal Co., LLC (In re HNRC Dissolution Co.)*, 371 B.R. 210 (E.D. Ky. 2007).

APPENDIX B

In re HNRC DISSOLUTION COMPANY f/k/a Horizon Natural Resources Company, et al., Debtors.

Zurich American Insurance Company, Appellant,

v.

Lexington Coal Company, LLC, Appellee.

Civil Action No. 06–104–DLB.
Bankruptcy No. 02–14261.

United States District Court,
E.D. Kentucky, Northern Division, at Ashland.

July 2, 2007.

Order Denying Stay July 26, 2007.

MEMORANDUM OPINION & ORDER

BUNNING, District Judge.

I. INTRODUCTION

Pursuant to 28 U.S.C. § 158(a)(1), Appellant, Zurich American Insurance Company ("Zurich"), brings this appeal against Appellee, Lexington Coal Company ("LCC"). Appellant seeks relief from a final order of the United States Bankruptcy Court for the Eastern District of Kentucky, Ashland Division, denying Zurich's application for allowance of an administrative ex-

pense claim.[1] The primary issue on appeal asks whether prospective post-confirmation deductible payments on insurance policies entered into by the former Debtors' estate with Zurich during the pendency of the bankruptcy are entitled to administrative expense priority under 11 U.S.C. § 503.[2]

This matter is presently before the Court by way of Appellant's Notice of Appeal from Bankruptcy Court (Doc. # 1) and Appellant's Opening Brief (Docs.# 12, 14) seeking reversal of the Bankruptcy Court's denial of Zurich's administrative expense claim or, in the alternative, remand to the Bankruptcy Court for further hearings to allow Zurich to present evidence in support of its claim. LCC subsequently filed a Brief for the Appellee (Doc. # 24) and Zurich responded with its Reply Brief (Doc. # 26). Oral argument was held on June 15, 2007 with Karen Turner present for Zurich and Gregory Schaaf present for LCC. Therefore, this appeal is now ripe for adjudication by the Court.

II. BACKGROUND DISCUSSION

A. Summary

During the period from June 29, 1998, to September 30, 2004, Zurich and its affiliated companies pro-

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[1] The underlying bankruptcy action is Case No. 02-14261 and is styled *In re HNRC Dissolution Co., f/k/a Horizon Natural Resources Co., et al.*, 343 B.R. 839 (Bankr. E.D. Ky. 2006). The orders in question, from which this appeal is taken, are the Memorandum Opinion (Bankr. Doc. # 7404) ("Opinion") and related Order (Bankr. Doc. # 7406) ("Order").

[2] This matter is properly before this Court pursuant to Appellant's election under 28 U.S.C. § 158(c)(1)(A), which permits an appellant to have a case heard by a district court in lieu of the Bankruptcy Appellate Panel.

vided workers' compensation, general liability and business automobile insurance coverage (the "Zurich Policies") to certain of the above-captioned debtors (collectively, the "Debtors") on various policies containing "deductibles." On a deductible policy, the insured agrees to retain some of the risk of claims and the insurance company reduces the premium accordingly. Under Zurich's Insurance Program, the insured was not obligated to pay the deductible in full upon the occurrence of the claim, but rather Zurich would advance money to pay losses and expenses and the insured would not pay until billed. These advances were interest free.

Zurich's administrative expense claim is a claim for the amount of the Ultimate Loss Projection (as defined herein) minus collateral or loss fund held and minus past payments made by the Debtors for deductibles. The present projected amount of the administrative claim is $14,593,567.79, an amount that would have been less but for the insolvency of Frontier Insurance Company, the insurance company that provided certain collateral bonds to secure the Debtors' obligations as principal obligor. As confirmed during oral argument, these bonds now appear to have de minimis value.

B. Procedural History

On November 13 and 14, 2002 (the "petition" dates), the Debtors filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Eastern District of Kentucky, Ashland Division (the "Bankruptcy Court"). Following the failure of the Debtors' efforts to reorganize on a stand-alone basis, the decision was made to pursue the sale of substantially all of Debtors' assets.

On August 17, 2004, the Debtors conducted an auction of substantially all of their remaining assets in accordance with bidding procedures previously approved by the Bankruptcy Court. On September 16, 2004, the Bankruptcy Court entered two orders confirming the Debtors' Plans (collectively, the "confirmation Orders"), which granted authority to LCC to object to, as well as the authority to resolve and settle, all administrative expense claims in the first instance as a primary asset purchaser. The Debtors subsequently closed the sale of their assets to the approved purchasers, and the Debtors' plans, as modified by the Confirmation Orders, became effective on September 30, 2004 (the date of "confirmation" or "liquidation"). Zurich, although aware of the confirmation hearings and the bankruptcy generally, did not participate in the proceedings.

According to the confirmed plans, a bar date of December 29, 2004 was established for the filing of administrative expense claims (but not ordinary course administrative expense claims). On December 29, 2004, Zurich filed its Administrative Expense Request Form, identified as claim no. 20675 on the Debtors' claims register (the "Administrative Expense Claim").[3] Through its Administrative Expense Claim, Zurich seeks payment from the Debtors, now LCC, for deductible obligations as an administrative expense based on Zurich's ultimate loss projection from claims based upon the

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[3] The Administrative Expense Claim is made up of: (a) the Administrative Expense Request Form, (b) an Addendum to Administrative Expense Request Form, (c) Exhibit A, titled "The Insurance Contracts", and (d) Exhibit B, titled "Collateral Charge Summary."

relevant insurance policies during the pendency of the bankruptcy.

On February 18, 2005, LCC filed its Objection to Claim of Zurich American Insurance Company (Bankr. Doc. # 5492) (the "Initial Objection"). On July 29, 2005, LCC filed its Supplemental Objection to Claim of Zurich American Insurance Company (Bankr. Doc. # 6646) (the "Supplemental Objection," and, together with the Initial Objection, the "Objection"). On August 31, 2005, Zurich filed its Response to Supplemental Objection of LCC to Claim of Zurich American Insurance Company (Bankr. Doc. # 6853) (the "Response"). On September 15, 2005, LCC filed its Reply to Response to Supplemental Objection of LCC to Claim of Zurich American Insurance Company (Bankr. Doc. # 6918) (the "Reply").

Thereafter, on November 21, 2005, the Bankruptcy Court entered an order requiring the parties to tender joint stipulations and a list of exhibits (Bankr. Doc. # 7071). On January 24, 2006, Zurich and LCC filed the Agreed Stipulated Facts and List of Exhibits of Zurich American Insurance Company and Lexington Coal Company, LLC (Bankr. Doc. # 7180) (the "Stipulated Facts"). Subsequently, on May 30, 2006, the Bankruptcy Court entered its Memorandum Opinion and Order ("Bankruptcy Opinion") denying Zurich's Administrative Expense Claim (Bankr. Doc. # 7406). On June 9, 2006, Zurich timely filed its Notice of Appeal (Bankr. Doc. # 7432).

C. Insurance Policies

Prior to and after the petition dates, Zurich provided insurance coverage to the Debtors. Zurich and two of its affiliated companies, American Zurich Insurance Company ("American Zurich") and Steadfast Insurance Company ("Steadfast"), issued various insur-

ance policies to the Debtors covering both the pre-petition and post-petition periods, including but not limited to workers' compensation insurance, business automobile insurance, and general liability insurance.

The Zurich Policies were deductible policies. On a deductible policy, the insured agrees to retain some of the risk of claims within the deductible layer. In other words, similar to automobile or other personal insurance plans, the insured agrees to pay a certain amount for an expense on a claim where the insurer is then responsible for any amount of expense that exceeds the deductible ceiling. In this instance, Zurich would advance the money to pay the losses and expenses and the Debtors would then reimburse Zurich when billed for the deductible costs under the policy.[4] For some of the earlier Zurich Policies, the Debtors made payments within the deductible layer to a third-party administrator. Under the deductible agreement between the Debtors and Zurich, default occurs when the insured "fail[s] to pay any amount when it is due under this Agreement...."

Many companies purchase insurance policies that contain deductibles agreements so that they pay a smaller premium in exchange for agreeing to bear the risk of claims within the deductible layer, similar to personal automobile insurance. These policies are gen-

[4] Advancing deductible costs is less common where the insured is an individual, rather than a business. Where the deductible costs are not advanced, the care provider (in a health insurance context) seeks out the deductible payment or "co-pay" from the individual that is insured, instead of the insurance company paying the entire amount due to the care provider and then billing the insured for the deductible costs (i.e., advancing deductibles).

erally less expensive than policies with no deductibles—commonly referred to as "guaranteed cost" policies—even after considering the insured's exposure to deductibles. Here, because the Debtors purchased deductible policies, their agreed-upon premiums were reduced as a result of absorbing some of the risk to the insurer, Zurich, by way of paying costs within the deductible layer when claims arise. These deductible costs, as discussed above, would initially be paid in full by Zurich to the relevant care provider (or other payee), and Zurich would subsequently bill the Debtors for the deductible costs that were advanced under the terms of the policies.

In the insurance industry, claims are either considered "open" or "closed." Claims that are currently active are termed "open." However, an inactive or closed claim may be reopened sometime in the future due to circumstances surrounding the nature of the claim. In other words, although a claim may occur during a policy coverage period and may even be closed before the expiration of the coverage period, the claim may be reopened and costs may be incurred in connection with the prior coverage at some juncture after the coverage has expired; payments on some types of claims may extend over many years. Because costs often arise after the end of a coverage period that the insurer must still pay if the costs stem from a claim filed within the coverage period, there is also an ongoing deductible obligation of the insured beyond the mere termination of the coverage period. This is the scenario under which the current action arises.

For example, a worker may suffer a compensable injury on December 1, 2002, but receive compensation payments and medical reimbursements over many years. Perhaps the condition abates but flares up in fu-

ture years. Or the injury might be latent and manifest itself years later. In the case of workers' compensation insurance, a claim might remain open for years or may be open, closed, and then reopened. In the insurance industry, therefore, insurance companies need to understand and calculate the total expected exposure, referred to herein as the ultimate loss projection (the "Ultimate Loss Projection").

When an insured's ongoing deductible obligation is not limited pursuant to a deductible agreement, as in the current context, an insured will need to know (i.e., estimate) these prospective deductible obligations of the insured in order to project its future cash requirements and issue accurate financial statements. Insurance companies also need to know this amount to prepare for future payments and negotiate with the insured as to how these amounts will be paid or secured, such as through the posting of collateral or loss funds, assuming alternatives are even allowed by the applicable deductible agreement or negotiated in a renewal policy.

Both parties to major insurance contracts typically utilize the expertise of actuaries to calculate the ultimate loss projection within industry standards. The actual deductible obligations of an insured may be less than or greater than the insurance company's Ultimate Loss Projection. Considering only the amounts that have been paid on claims as of a specific date may not present a complete picture of the total liability for deductibles over time, depending on the language of the deductible agreement.

There can be no question that here, as in many contexts, the insurance coverage provided by the Zurich Policies was critical to the Debtors' operations. With-

out the insurance provided by Zurich, the Debtors would have been unable to operate their business as a going concern both prior to and during the pendency of the bankruptcy.[5] Specifically, the workers' compensation insurance and business automobile insurance were vital to the Debtors' business. Even so, Zurich continued coverage of the Debtors during bankruptcy with full knowledge that the deductible obligations of the soon-to-be dissolved estate may not survive the liquidation. Although Zurich attempted to negotiate varying forms of protection for the prospective deductibles that would inevitably arise in the future and likely post-confirmation, it now appears that some of this protection—namely bond collateral—will not sufficiently cover the entire ultimate loss projection, which constitutes mere educated speculation at this stage.

D. Policy Renewal

In September 2002, which was mid-policy for the year ending June 2003, Zurich raised the issue of collateral with the Debtors to offset its potential risk from advancing deductible costs under the terms of the policy. At that time, the Debtors' consultant prepared an estimate. The Debtors began negotiating a renewal policy with Zurich in January 2003, two months after Debtors' filed for bankruptcy reorganization. At the same time, the Debtors also pursued discussions with AIG and Old Republic to obtain competing bids from different insurance carriers. Zurich's premium request was nearly half of the amount Old Republic sought for

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[5] State law actually required the Debtors to carry workers' compensation coverage, so the insurance policies themselves necessarily constituted a significant benefit to the estate in that the coverage allowed the Debtors' business to operate.

similar coverage terms. AIG did not provide Debtors with a quote.

In May 2003, in preparation for a June 2003 policy renewal, Zurich again discussed with the Debtors the need for additional collateral to offset the risk to Zurich, primarily surrounding the Debtors' prospective deductible obligations under the policy. In these discussions, Zurich explained the "loss pick"[6] with the insured and discussed the appropriate level of collateral. Zurich initially sought $15,000,000 in collateral, but by the end of the negotiations, Zurich and the Debtors agreed to collateral in the amount of $10,000,000, which Zurich agreed to receive following the effective date of what was then going to be a stand-alone plan of bankruptcy reorganization.[7] The date of the payment was subsequently changed when the bankruptcy plan shifted from mere reorganization to liquidation of assets and, ultimately, liquidation of the Debtors' estate.

Between collateral—$31 million for workers' compensation and black lung only—and premium costs, the Debtors estimated that the insurance program would cost approximately $50 million to fund for the relevant coverage period. While Zurich and the Debtors continued to negotiate collateral, a short-term extension beginning June 2003 was negotiated with only a 22% premium increase, which represented a discounted rate

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[6] The "loss pick" is the estimation of the ultimate loss made at the beginning of the policy period.

[7] The reduction in the negotiated collateral amount also included the replacement of certain bonds that would presumably be of greater risk than the collateral with which they were replaced. These replacement Frontier bonds, which Zurich now values at zero, were undated and the true value unknown.

under market conditions and relative to the finalized terms of the policy reached by the Debtors with Zurich. At the end of the final negotiations, Zurich and the Debtors agreed to collateral of $10 million and, by way of the June 2004 Amended Order (discussed *infra*), the date for payment of the $10 million was altered due to the shift from reorganization to liquidation.

E. Assumption of Policies

During the course of their chapter 11 proceedings, the Debtors assumed the Zurich Policies. On September 5, 2003, the Debtors filed with the Bankruptcy Court the Motion of Debtors for Orders Authorizing Assumption of Certain Insurance Contracts (Bankr. Doc. # 1785) (the "Motion to Assume"). Pursuant to the Motion to Assume, the Debtors sought to assume the Zurich Policies and Program[8] pursuant to section 365 of the Bankruptcy Code. In the introductory paragraph of the Motion to Assume, the Debtors stated that they sought an order from the Bankruptcy Court authorizing the "assumption by the Debtors of certain insurance contracts between the Debtors and Zurich American Insurance Company and its affiliates ('Zurich') and other insurers (the 'Contracts')."

On September 23, 2003, the Bankruptcy Court entered the Order Granting the Motion of Debtors for an Order Authorizing Assumption of Certain Insurance Contracts (the "Assumption Order"). According to Ap-

[8] "Program" was defined in the Motion to Assume at Section 6 as follows: "Since 1998, Zurich (including its affiliated companies) has provided worker compensation, business automobile, general liability and other coverages as part of an insurance program for Horizon and its predecessors and affiliates and all related deductible agreements and specifications thereto (the 'Program')."

pellant, Zurich repeatedly communicated to the Debtors that any assumption would be conditioned upon the Debtors assuming all liabilities for all policies.[9] Attached to the Motion to Assume were various revised binders for the renewals, each of which contains the condition that "The Debtors assume all the Zurich policies for all years ('the Policies') and all liabilities under Section 365." The binders also state that "Zurich receives administrative expense treatment for all monies due under the Policies."

All of the insurance coverage extended by Zurich to the Debtors under the Assumption Order was subject to renewal on June 29, 2004. Zurich chose not to renew the insurance policies, which was valid under the terms of the insurance policies. Subsequent to the nonrenewal, however, Zurich and the Debtors negotiated terms for extending the coverage period. These negotiations between the Debtors and Zurich resulted in the June 25, 2004 Stipulation and Amended Order Authorizing Assumption of Insurance Contracts with Zurich American Insurance Company (Bankr. Doc. # 3381) (the "June 25, 2004 Amended Order").

Section J of the June 25, 2004 Amended Order provides that "the Debtors believe that they will be able to meet all of their ongoing and future obligations under the insurance contracts, as and when they become

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[9] Additionally, Paragraph 8 of the Debtors' Motion to Assume states: "Zurich informed the Debtors that assumption under section 365 of the Bankruptcy Code of the entire package—all programs, all policies, and all liabilities—would be a condition of any renewal, and that Zurich's expectation was that the Debtors would continue to meet all their obligations as they came due."

due...." Additionally, footnote 3 of the June 25, 2004 Amended Order states:

> The projected total liability by the Debtors that will be due and owing to Zurich over the lifetime of the payments under the Insurance Contracts is in excess of $10,000,000, and Zurich retains the rights to assert an administrative claim for the balance of any claims under the Insurance Contracts. The Debtors reserve the right to object to any additional administrative claim asserted by Zurich.

The June 25, 2004 Amended Order required the Debtors to pay premiums of almost $900,000 per month; provide additional cash collateral or letters of credit of $1,255,000 per month; and provide $10 million in additional cash collateral at the effective date.[10]

Although the annual Zurich Policies would have expired on June 28, 2004, the June 25, 2004 Amended Order allowed for the policies to be extended on a month-to-month basis. There were three 30-day extensions thereafter and Zurich subsequently granted two one-day extensions for a pro rated premium, which Zurich booked on its records as one two-day extension. The final monthly extension expired on September 28, 2004 at 12:00 midnight, two days before the final bankruptcy plan was confirmed, and the Debtors' estate dissolved.

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[10] Further, section 8 of the June 25, 2004 Amended Order provides: "The Debtors acknowledge that Zurich is drawing on certain surety bonds and letters of credit provided by certain third parties, which funds are being placed in the loss funds under the deductible agreements and specifications between the Debtors and Zurich."

F. Liquidation of the Estate

On July 11, 2004, the Debtors filed their liquidating plans (the "Plans"), which contemplated the sale of substantially all of the Debtors' remaining assets to the successful buyer or buyers at an auction to be conducted by the Debtors in accordance with bidding procedures previously approved by the Bankruptcy Court. On August 17, 2004, the Debtors conducted their auction of their remaining assets and the successful bidders were Newcoal, LLC, now known as International Coal Group ("ICG"), Oldcoal (now known as Lexington Coal Company), and A.T. Massey Coal Company.

On August 31, 2004, the Bankruptcy Court held a hearing on the proposed sale of assets and confirmation of the Plans and indicated its intention to approve the sale and confirm the Plans, as modified by the Debtors and by the Bankruptcy Court's ruling. At the confirmation hearing, the Debtors were required to prove they could pay allowed administrative expense priority claims. The Debtors' financial consultant testified at the hearing that there would be a cushion in excess of $20 million for administrative expense claims. Zurich did not enter an appearance at the hearing regarding its forthcoming administrative expense claim that would surpass the entire amount of funds allocated by the Plans for satisfying the priority claims.[11]

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[11] At present, however, the parties have informed the Court that there are sufficient funds in the administrative expense pool to cover Zurich's claim amount as it currently stands ($14.5 million). However, LCC asserts that this money was set aside to cover other anticipated regulatory liabilities that may reduce, or possibly eliminate, the pool.

As indicated in the notices of effective date of the Plans (Bankr. Docs. # 4220 and 4221), on September 30, 2004, the Debtors closed the sale of their assets to the approved purchasers and the Plans became effective. As of the closing, the Debtors were deemed dissolved in accordance with the Confirmation Orders. The Zurich Policies were not assumed by asset purchasers ICG, LCC, or Massey as part of the Sale. Zurich never entered an appearance in the Bankruptcy Cases until the filing of its administrative claim now in controversy, which was filed post-confirmation but prior to the bar date for priority claims as established by the Plans.

G. Zurich's Administrative Expense Claim

The Plans define an "Administrative Expense Claim" as consistent with governing law, stating as follows:

> Administrative Expense Claim means any right to payment constituting a cost or expense of administration of any of the Chapter 11 Cases under section 503(b), 507(a)(1), 507(b) and 1114(e)(2) of the Bankruptcy Code, and applicable case law including, without limitation, any actual necessary costs or expenses of preserving the Estate, all compensation and reimbursement of expenses to the extent Allowed by the Bankruptcy Court under section 330 or 503 of the Bankruptcy Code, and any fees or charges assessed against the Estates of the Debtors under section 330 or 503 of the Bankruptcy Code, and any fees or charges assessed against the Estates of the Debtors under section 1930 of chapter 123 of title 28 of the United States Code.

The bar date for filing administrative expense claims under the Plans was December 29, 2004. The bar dates contained in the Plans do not, by their terms, apply to "Ordinary Course" expenses.

In accordance with the applicable bar date, Zurich filed an Administrative Expense Request Form and attachments on or about December 29, 2004, identified as claim no. 20675 on the Claims Register ("Zurich's claim"). The claim was in the amount of $44,744,067. According to Zurich, its claim was filed as a protective measure to ensure payment of administrative expenses incurred by Zurich in the event that the surety bonds and other collateral provided by the Debtors to Zurich to secure the Debtors' payment of insurance deductibles are ultimately dishonored or otherwise fail to cover the prospective deductible obligations.

H. Zurich's Loss Projections

As detailed herein, an ultimate loss projection is essentially a report prepared by actuaries with the basic purpose of estimating future obligations in connection with insurance coverage. In connection with its filing for an administrative expense priority for future deductible obligations of the Debtors, Zurich has projected that the ultimate deductible loss (i.e., obligation) under the Zurich Policies will be $46,858,757, which does not include any legal costs and expenses that are generally reimbursable by the Debtors under the Zurich general liability policies. Although Zurich expects to incur additional defense costs on the general liability policies, Zurich has not requested reimbursement of current or future defense costs related to the general liability policies.

Ultimate loss projections are actuarial analyses of the projected ultimate cost made on a regular periodic

basis, which employ information provided by the insured and updated loss information. These projections are used in the insurance industry to forecast total deductible liability on policies where the insured has agreed to be responsible for such liabilities and where such liability will inevitably extend into the future. This is especially true for insurance policies providing workers' compensation coverage, which can extend years past policy expiration. Consequently, and as reflected in the Ultimate Loss Projection, the workers' compensation claims are by far the largest of the total claims arising under the Program.

Because ultimate loss projections require actuarial judgment, two actuaries using the same data may arrive at different conclusions as to a reasonable expected value of the ultimate losses, although the conclusions should be inside a range of reasonable estimates of the ultimate losses. Notwithstanding any uncertainty that is inevitably present when predicting future obligations, insurance companies, such as Zurich, regularly create, maintain, and rely upon these actuarial reports in their ordinary course of business.

In terms of the methodology for calculating the ultimate loss projection for each separate policy, Zurich's projection takes into account numerous variables.[12]

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[12] In constructing the projections, Zurich identifies, among other things, the policy period, the maximum amount of deductible liability, exposure amount as determined by information provided by the insured and updated as per audits, claims made for the policy period ("Deductibles Incurred"), claims paid, deductibles paid on behalf of the insured ("Deductibles Paid"), the estimated ratio of the ultimate value of known and unknown claims over current/reported losses ("Incurred LDF"), the estimated ratio of the ultimate value of claims known and unknown over current paid

According to Zurich, the methodology and data used in calculating the Ultimate Loss projection is based on widely accepted and employed industry standard actuarial methods of establishing deductible claims. Based on a review of the relevant factors, Zurich then selects an appropriate loss number depending upon the circumstances of the policy and policy period as they relate to those factors.

Pursuant to the obligations of the Debtors in the June 25, 2004 Amended Order, Zurich holds cash collateral received from the Debtors in the amount of $1,255,000. In addition to the cash collateral, Zurich received a letter of credit equal to $2,510,000. The letter of credit, along with others totaling $7,900,000, were liquidated and placed in loss funds in connection with the Debtors' prospective deductible obligations. Zurich also received the payment of $10,000,000 required by the June 25, 2004 Amended Order close to the Effective Date.

Zurich has asserted that the deductible payments previously received by Zurich and third-party administrators from the Debtors total $9,526,055.24. The initial $44,744,067 listed as Zurich's administrative expense on the Administrative Expense Claim did not subtract deductible payments previously received by Zurich and third-party administrators from the Debtors, which are required deductions to arrive at the amount of Zurich's

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losses ("Paid LDF"), estimates of ultimate losses as the product of Deductible Incurred Losses and the Incurred Loss Development Factors ("Developed Incurred"), Developed Paid (product of Paid LDF and Deductible Paid), the Loss Pick, the weighted average between the Developed Incurred and the Loss Pick, and the weighted average between Developed Paid and the Loss Pick.

asserted Administrative Expense Claim. If the Zurich Administrative Expense Claim shown on the Zurich Claim Form was calculated by deducting the payments previously received by Zurich and third-party administrators, the Zurich Filed Claim Form would have requested an Administrative Expense Claim of \$35,218,011.76 (\$44,744,-067.00 less the \$9,526,055.24 in payments).[13]

The amount of Zurich's administrative expense claim as it now stands, approximately \$14.5 million, was calculated by taking the Current Ultimate Loss Projection minus the collateral or loss fund and payments made by the Debtors for deductibles in the past. Zurich projects that the current deficiency amount is \$14,593,567.79, which would have been substantially reduced if Frontier had paid the surety. The vast majority of the Current Ultimate Loss Projection is for workers' compensation insurance coverage. Some or all the Deductible Agreements in connection with the policies contain different deductible amounts or aggregates

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[13] Zurich also holds the following bonds issued by Frontier Insurance Company as collateral against the Debtors' prospective deductible obligation under the Zurich Policies:

Bond No. 153883 (effective 4/30/00) \$2,600,383
Bond No. 153261 (effective 6/29/98) \$2,979,500
Bond No. 153262 (effective 6/29/99) \$3,323,700
Bond No. 153882 (effective 4/30/00) \$2,500,000
Bond No. 153800 (effective 6/29/99) \$3,285,898

Frontier Insurance Company ("Frontier") contends that Bond No. 153261 and Bond No. 153800 were cancelled or expired and the remaining bonds have nominal value. The ability to collect under the Frontier bonds is in dispute. Frontier is in receivership in the State of New York. Zurich made a claim on all of the bonds in July 2004.

for black lung or other types of claims. The Deductible Agreements control these amounts.

I. Bankruptcy Opinion

The Bankruptcy Opinion (Bankr. Doc. # 7404) and related Order (Bankr. Doc. # 7406), issued on May 30, 2006, denied Zurich's application for allowance of an administrative expense priority claim in connection with prospective deductibles on the Zurich Policies. Ultimately, the Bankruptcy Court held that Zurich failed to provide "any authority for its proposition that a claimant is entitled to administrative expense priority for claims that arise after the confirmation of a plan and after the estate ceases to exist."

The Bankruptcy Court also took issue with the prospective nature of the deductible obligations in that they require some degree of subjective determination:

> At this point, Zurich has provided nothing more than "its own statistical analysis of the likelihood such claims will occur" for the purpose of estimating its claim, and the court finds such analysis no more supportive of its claim than the *Eli Witt* court did. The court does not see how Zurich can ever provide anything more than a statistical analysis until the events that precipitate a claim for deductibles occur. These events, by necessity, will occur post-confirmation.

Further, the Bankruptcy Court was not even convinced that estimation is proper under the Bankruptcy Code in this case because estimation for the purpose administrative expense claims typically occurs in the "post-petition, pre-confirmation period of estate administration."

Finally, the Bankruptcy Court took issue with Zurich's failure to participate in the bankruptcy process until after the confirmation of the Plans. This failure, according to the Bankruptcy Court, "necessarily deprived" the creditors and other parties in interest "of the opportunity to factor in a huge administrative expense claim that would have had a major effect on the consideration of the feasibility of the Debtors' proposed Plans." Accordingly, the Bankruptcy Court concluded that "Zurich should have participated in the Debtors' cases and requested an estimation of its administrative expense claim prior to the confirmation process" and, therefore, "Zurich's request for estimation is neither appropriate nor timely under these circumstances."

Following the Bankruptcy Court's denial of Zurich's claim, Zurich filed a Notice of Appeal on June 9, 2006 (Bankr. Doc. # 7432). On June 16, 2006, Zurich filed its Statement of Issues and Designation of Items to be Included in the Record on Appeal (Bankr. Doc. # 7447). LCC subsequently filed its counter-designation of items to be included in the record on June 26, 2006 (Bankr. Doc. # 7460). The record from transferred from the Bankruptcy Court to the District Court, and the appeal was docketed, on July 11, 2006 (Bankr. Doc. # 7481). The Notice of Appeal was entered with this Court on July 12, 2006 (Doc. # 1).

III. ANALYSIS

At the outset, the Court recognizes that the only question which must be determined is how the prospective deductible obligations are to be treated, not whether they are in fact "legal" obligations. In other words, it is undisputed that Zurich will be rightfully "owed" any deductible obligations advanced under the Zurich Policies (pursuant to the Deductible Agree-

ments) when they "arise," but it is not patently clear if the obligations constitute expenses incurred in the administration of the bankruptcy estate or mere debt owed under contract to which Zurich could attempt to recover as a creditor of the dissolved estate. The very narrow issue, therefore, is whether the prospective deductible obligations claimed by Zurich should receive administrative expense treatment whereby Zurich would be given priority above that afforded to most creditors.

The practical consequences of the legal distinction between administrative expenses and liability incurred outside the administration of the bankruptcy can prove significant in many cases. Should priority status be granted to Zurich in this matter, the requested claim amount would "come off the top" before the proceeds of the estate liquidation would be distributed among the unsecured creditors of the nowdefunct Debtors. Where, as here, a pool of funds has been previously set aside to satisfy administrative expense claims made against the estate, Zurich's requested claim amount would be withdrawn from the "priority pool" if priority status is granted.[14] Any funds that remain in the pool, including part or all of the funds Zurich now requests

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[14] Although the nearly $20 million remaining in the "pool" is sufficient to cover Zurich's administrative expense claim, which currently stands at approximately $14.5 million, LCC maintains that the "excess" pool amount was set aside as part of an agreement with regulatory authorities for reclamation purposes. Consequently, according to LCC, because the large majority of the funds in the pool were not intended for traditional administrative expense claims (other priority claims were already satisfied), the pool would fail in large measure to cover both Zurich's claim and the "intended" reclamation costs.

should priority status be denied, may revert back to asset-purchaser LCC or be utilized for other means (e.g., reclamation) under the terms of the Plans and Confirmation Orders.

A. Standard of Appellate Review

On appeal from the Bankruptcy Court pursuant to 28 U.S.C. § 158(a)(1), this Court reviews the Bankruptcy Opinion *de novo* as to its conclusions of law. *See In re Made in Detroit*, 414 F.3d 576, 580 (6th Cir. 2005). Any findings of fact are upheld unless they are found to be clearly erroneous. *See id.* However, the Bankruptcy Opinion is largely founded upon findings of fact based solely on voluntary stipulations by the parties as set out in the Agreed Stipulated Facts and List of Exhibits (Bankr. Doc. # 7180) ("Stipulated Facts"). To the extent the findings of fact within the Bankruptcy Opinion stem from the Stipulated Facts, those facts are binding on this Court. *See Varga v. Rockwell Int'l Corp.*, 242 F.3d 693, 699 (6th Cir. 2001).

B. Administrative Expense Priority Not Warranted

1. "Actual" and "Necessary"

The United States Bankruptcy Code (the "Code") defines administrative expense priority claims as the "*actual, necessary* costs and expenses of *preserving* the estate." 11 U.S.C. § 503(b)(1)(A) (emphasis added). The Code's definition of administrative expenses provides the boundary for the aforementioned distinction between claims of general creditors and administrative expense claims, whereby the latter receive priority over the former.[15] The rationale behind the priority

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[15] In actuality, administrative expense status provides that, pursuant to 11 U.S.C. § 507(a)(1), the administrative claim is

provisions within the Code, at least in the liquidation context, is to facilitate the continued operation (i.e., going concern) of debtors-in-possession "by encouraging third parties to provide those businesses with necessary goods and services" that enable the maximization of value for creditors of the estate upon liquidation. *In re United Trucking Serv.*, 851 F.2d 159, 161 (6th Cir. 1988).

Importantly, because of the overarching goal to "keep administrative expenses at a minimum and thus preserve the estate for the benefit of all creditors," it is well-established that "priority statutes are *strictly construed.*" *In re Patch Graphics*, 58 B.R. 743, 745 (Bankr. W.D. Wis. 1986) (emphasis added); *In re Colortex Industries, Inc.*, 19 F.3d 1371, 1377 (11th Cir. 1994) (Administrative expenses under § 503 "should be narrowly construed in order to maximize the value of the estate preserved for the benefit of all creditors."); *see also Otte v. United States*, 419 U.S. 43, 53, 95 S.Ct. 247, 42 L.Ed.2d 212 (1974); *In re Kmart Corp.*, 290 B.R. 614, 621 (Bankr. N.D. Ill. 2003); *In re The Eli Witt Co.*, 213 B.R. 396, 399 (Bankr. M.D. Fla. 1997); *In re D'Lites of America*, 108 B.R. 352, 355 (Bankr. N.D. Ga. 1989):

> [T]here must be a strict construction of the terms "actual" and "necessary" therefore requiring that the estate actually receives a real benefit from the transaction, before administrative priority will be granted on claims against the estate.... The focal point of the allowance of a priority is to prevent unjust enrichment of the estate, not to compensate

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treated as a first priority unsecured claim and is paid before all other unsecured creditors. *See United States v. Ginley (In re Johnson)*, 901 F.2d 513, 517 (6th Cir. 1990).

> the creditor for its loss.... Thus, a court looks to the actual benefit to the estate and not the loss sustained by a creditor.

In re Globe Metallurgical, Inc., 312 B.R. 34, 40 (Bankr. S.D.N.Y. 2004) (internal citations omitted).

To that effect, the narrow application of § 503(b)(1)(A) is rather unambiguous on its face: the claimed expense must have been an "actual" cost that is "necessary" to the "preservation" of the estate. *See In re Patch Graphics*, 58 B.R. at 745 (citing *In re Club Dev. & Mgmt. Corp.*, 27 B.R. 610, 612 (9th Cir. BAP 1982)) ("An administrative expense may not be allowed absent a finding that the expense is necessary for preserving the estate."). It is in this regard that Zurich's claim fails as a simple matter of statutory interpretation on both fronts: the claimed expenses are not "actual" (i.e., not yet realized) and the payment thereof, when the obligations are realized, cannot act to preserve an estate that no longer exists. At the moment Zurich's Claim was filed on the bar date for administrative expense claims, the ultimate loss projection for the deductible obligations was entirely speculative by nature and prospective by definition.

Nevertheless, despite LCC's subtle mention otherwise, there can be no question that Zurich will be forced to "advance" a substantial portion, if not all, of the deductible obligations in question.[16] A key consid-

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[16] At oral argument, Zurich was adamant that, regardless of whether its claim for administrative expense priority was granted, it would be required to continue advancing deductibles pursuant to the Deductible Agreements at risk of losing its insurance license even though the contracts themselves are presumably void following the bankruptcy confirmation that acted to discharge the Debt-

eration, however, is the reality that Zurich is only contractually obligated to pay the deductibles, and subsequently seek reimbursement, once the claims actually "arise." Zurich contends that "arise" in this context should be viewed from a more macro perspective, effectively arguing that, even though the legal obligation to pay the expenses will not accrue until sometime in the future, the underlying event giving rise to the future claim (e.g., an employee's initial injury) necessarily occurred during the bankruptcy administration.[17] In other words, Zurich asserts that the accrual of the claims should essentially relate back to the underlying insurance coverage as part and parcel of the relevant insurance policies, which include the premium obligations that were assigned administrative priority and satisfied accordingly. But Zurich does not, and cannot, provide any direct authority to support the contention

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ors' liabilities generally and specific legal obligations under contract (notably, the Zurich Policies were not assumed by LCC).

[17] It is important to understand the practical realities of how these deductible obligations will inevitably arise, and in large number. In oversimplified terms, an employee of the Debtors would have been covered by workers' compensation insurance through Zurich during the pendency of the bankruptcy via the debtor-in-possession's assumption of the Zurich policies. Therefore, when an event occurs that is covered by the policy, such as the injury of an employee, that injury will inevitably give rise to medical bills and other expenses. Even though the injury occurred during the coverage period, the effects of the injury will often times be felt for many years subsequent in the form of additional health care costs and the like. Because the later expenses stem from the original injury during the coverage period, the expenses will still fall under the domain of Zurich. And when dealing on such a large scale, these deductible expenses will reach well into the millions of dollars range; according to Zurich, the total deductible outlay will likely near $50 million.

that expenses necessarily realized post-confirmation can legally be characterized as "actual" under the Code.

Furthermore, even assuming that the claimed expenses can arguably constitute actual costs because they will inevitably occur to some significant degree and unquestionably stem from insurance coverage during bankruptcy, any argument that the payment of the claimed expenses is necessary to preserve the estate is unpersuasive. The bottom line remains that Zurich is not contractually obligated to pay any of the deductible obligations in question until claims are filed, which will necessarily occur post-confirmation. The moment Zurich is contractually permitted to seek reimbursement from the Debtors for the advanced deductibles, the estate will have already dissolved and the Debtors will cease to exist. Consequently, payment of the claimed expenses will in no way act to preserve an estate when there is no estate to preserve.

Administrative expense priority is granted only for the limited purpose of administrating, and thereby preserving, the bankruptcy estate. *See Reading Co. v. Brown*, 391 U.S. 471, 475, 88 S.Ct. 1759, 20 L.Ed.2d 751 (1968) ("[T]he words 'preserving the estate' include the larger objective, common to arrangements, of operating the debtor's business with a view to rehabilitating it." The Supreme Court acknowledged that, in the liquidation context, the parallel purpose is to preserve the estate as a going concern.). "Because there is no need to preserve an estate that has been terminated, costs that are incurred after that time are not administrative expenses of the estate." *Guy v. Terex Corp.*, No. 91-3687, 1992 WL 88978, at *4, 1992 U.S.App. LEXIS 10018, at *12 (6th Cir. 1992). Accordingly, Zurich's administrative expense claim fails to satisfy the requirements of § 503(b)(1)(A) because the claimed expenses were nei-

ther actual at the time of filing nor will they be necessary to preserve the bankruptcy estate when the expenses are ultimately realized.

2. "Benefit to the Estate" Test

In the Sixth Circuit, as well most sister circuits, a two-part test has arisen to aid in the determination of whether expenses that are the subject of an administrative claim should receive priority treatment pursuant to § 503 of the Code. The aptly named "benefit to the estate" test asks whether the claimed expenses: (1) arose from a transaction with the bankruptcy estate, and (2) directly and substantially benefitted the estate. *See In re Sunarhauserman, Inc.*, 126 F.3d 811, 816 (6th Cir. 1997) (citing *Employee Transfer Corp. v. Grigsby (In re White Motor Corp.)*, 831 F.2d 106, 110 (6th Cir. 1987)). The burden of proof rests with the moving party, Zurich, to demonstrate by a preponderance of the evidence that the claimed expenses are entitled to administrative priority. *See In re Kmart Corp.*, 290 B.R. at 621; *see also In re Patch Graphics*, 58 B.R. at 745 (citing *Woods v. City Nat. Bank & Trust Co.*, 312 U.S. 262, 268, 61 S.Ct. 493, 85 L.Ed. 820 (1941)) ("The burden of proof is on the party seeking an administrative claim.").

Although the benefit to the estate test "limits administrative claims to those where the consideration for the claim was received during the post-petition period," the test is facially silent—as is the case law (*see infra*)—as to prospective expenses arising post-confirmation that stem from a contractual arrangement entered into by the debtor-in-possession during bankruptcy. *Id.* It is in this respect that the refined benefit to the estate approach, which was developed largely in response to the common problem of characterizing

damages from legal judgments,[18] is of little assistance as applied to Zurich's claim in lieu of the traditional and statutory requirements of § 503(b)(1)(A).[19] Neverthe-

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[18] The Sixth Circuit, in *In re Eagle-Picher Industries, Inc.*, explained the development of the benefit to the estate test as a response to the Supreme Court's ruling in *Reading*, which permitted administrative expense priority for a post-petition tort claim:

> [T]he Bankruptcy Code defines administrative expenses incurred during the pendency of the bankruptcy and payable by the debtor as the "actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1). In *Reading Co. v. Brown*, 391 U.S. 471, 88 S. Ct. 1759, 20 L. Ed. 2d 751 (1968), the Supreme Court held that a postpetition tort claim against a debtor constituted an "actual and necessary cost" of the administration of the estate under § 503. Since then, and in reliance on *Reading*, this circuit (like many others) has used a two-part test to determine whether a claim is an administrative expense under § 503: "[A] debt qualifies as an 'actual, necessary' administrative expense only if (1) it arose from a transaction with the bankruptcy estate and (2) directly and substantially benefitted the estate." *In re Sunarhauserman, Inc.*, 126 F.3d 811, 816 (6th Cir. 1997).
>
> Applying Reading and this two-part test, courts have concluded that the following claims fall within the Code's definition of administrative expenses: tort, trademark infringement, patent infringement, and breach of contract. Under these precedents, [Appellee's] claims satisfy the traditional definition of "administrative expenses" so long as they arose from transactions that occurred between it and [debtor] after the petition for bankruptcy—which indeed they did.

447 F.3d 461, 464 (6th Cir. 2006) *("Eagle-Picher")* (some internal citations omitted).

[19] The benefit to the estate test is now frequently applied to cases involving pre-petition/postpetition controversies—e.g., *In re*

less, despite the difficulty in applying the test to the case *sub judice*, Zurich's claim again fails to warrant administrative priority under the benefit to the estate approach.

Even assuming arguendo that the expenses arose (or *will arise* in Zurich's case) from a transaction with the bankruptcy estate, accelerated reimbursement via administrative priority status will not act to provide a direct and substantial benefit to the estate where the claimed expenses will not become legal obligations until unknown points in the future, if ever. At first glance, the inquiry into whether claimed expenses provided a direct and substantial benefit to the estate engenders a temporal dilemma similar to, yet less workable in this context, than that posed by the "preservation of the estate" requirement under § 503. The timing problem arises because the question one must ask is whether the benefit should be measured at the moment the expenses become "actual" or whether it is appropriate to actuarially accelerate the reimbursement of the expenses because they stem from a contractual obligation entered into by the debtor-in-possession.

Predictably, as in the statutory debate under the language of § 503, Zurich argues under the benefit to the estate test that the claimed expenses satisfy the requirements for administrative priority because the prospective deductible obligations, as part and parcel of the underlying insurance policy, provided a vital ser-

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Sunarhauserman—but the traditional problem of how to treat law suit judgments spanning either the beginning or end of a bankruptcy are still common. *See, e.g.*, *Eagle-Picher*, 447 F.3d at 461 (administrative expense claim confined to post-petition damages stemming from a patent-infringement action).

vice to the Debtors by enabling continued operation of the estate during bankruptcy. LCC acknowledges the incontrovertible benefit that the insurance coverage itself provided to the Debtors' estate, but contests the characterization of the speculative expenses as beneficial to the estate because the claims won't arise until post-confirmation when the estate has dissolved.

As in the analysis under the traditional statutory framework of § 503, the benefit inquiry as applied to Zurich's claim essentially asks whether expenses that arise and are incurred post-confirmation should relate back to the underlying contractual arrangement during the bankruptcy where such arrangement did not cognize the acceleration of the speculative expenses. The resolution of this controversy comes from the adjudicatory constraint placed on the Court, as established *supra*, to strictly construe the requirements and the ultimate allowance of priority claims under the Code. *See In re Kmart Corp.*, 290 B.R. at 621 ("[T]he claimant must demonstrate that the benefit is more than a speculative or potential benefit.").

Applying a purpose-driven and narrow construction of both the statutory and common law approach for administrative claims, as is mandated by the general priority scheme of the Code, there is only one conclusion that can be reached under the unique circumstances in this case: the payment of the deductibles, when and if they should arise (i.e., become "actual"), does not provide a direct and substantial benefit to, nor act to preserve, a bankruptcy estate where there is no longer an estate to benefit. In the end, beyond the reality that the deductibles will not come due until after the estate dissolved (which is also common in the post-confirmation judgment cases), it is the special case here

that the deductible obligations do not even exist until claims arise whereby Zurich must advance payment.

As such, this is not a situation where Zurich's claim encompasses only pre-confirmation expenses from post-petition events that will be paid post-confirmation; rather, Zurich's claim requests expenses that will necessarily be paid post-confirmation because the "claims" giving rise to the expenses will necessarily occur post-confirmation. Accordingly, just as Zurich's claim is not for actual expenses necessary to the preservation of the estate, the claimed expenses similarly fail to provide a direct and substantial benefit to the estate. *See In re Oread, Inc.*, 269 B.R. 871, (Bankr. D. Kan. 2001) (interpreting *In re Eli Witt*, 213 B.R. at 400) ("Even for injuries suffered in postpetition accidents, if the claim had not been presented by the time of plan confirmation, it could not be characterized as an actual claim, necessary to the preservation of the estate.").

3. Case of First Impression

As the parties readily acknowledged during oral argument, there is an unfortunate lack of precedent capable of shedding light upon the rare issue at hand. Both parties attach a significance to this realization. According to Zurich, the reason for the novelty is simply because in the past, and across the entire spectrum of insurers providing coverage to debtors-in-possession during bankruptcy, the insurance companies have always recouped their deductible expenses. Regardless of whether this has historically been accomplished through private agreements, sufficient or excess collateralization, or even unpublished agreed orders, Zurich insists that this matter is not unique in its facts, but rather it is unique only to the extent that the debtor (now represented by LCC) has decided to challenge the

ability of the insurance company to receive reimbursement of its deductible loss projections by way of administrative expense priority.[20] On the other hand, LCC asserts that this type of case is extremely rare because the insurance companies typically take large strides to protect their interests when negotiating coverage of a financially unstable company, whether by means of securing greater cash outlay during the bankruptcy coverage period or by adequately collateralizing the risk inherent with deductible policies.[21]

Despite the void of controlling authority, the decision reached in *In re Eli Witt* involves a very similar factual scenario and, as a result, the parties have discussed the case at length and the decision was relied

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[20] Aside from the explanations of Zurich, it is clear to the Court that this controversy has only reached this stage because of the failed collateral, which Zurich incidentally required to offset some of the risk attendant to deductible policies, especially those entered into with companies in bankruptcy, despite an alleged custom in bankruptcy that priority status is routinely awarded for insurers in Zurich's shoes.

[21] Neither party suggests that guaranteed cost policies (i.e., non-deductible policies) are the norm or even utilized to any meaningful degree by debtors in bankruptcy. The reluctance toward guaranteed cost policies stems from the prohibitive costs associated with the policies because insureds are effectively paying for the prospective deductible obligations up-front, which places all of the risk on the shoulders of the insurer because the deductible obligations may far exceed actuarial estimations (Zurich claims that there was such an underestimation of ultimate loss projections in this case, for which Zurich is still paying the price). In fact, during oral argument, Zurich estimated that the premium costs of a guaranteed cost policy for the Debtors during bankruptcy would have been well over five times that of the deductible policy ($10 million for the entire period vs. at least $50 million for only one year).

upon heavily by the Bankruptcy Court below. *See In re The Eli Witt Co.*, 213 B.R. 396 (Bankr. M.D. Fla. 1997). As Zurich now requests in the current matter, the insurance company in *Eli Witt* asserted "an administrative expense for claims it calculate[d] it [would] have to pay in the future due to accidents or occurrences which. occurred postpetition, but which it [would] not have actually paid by confirmation." *Id.* at 398. In response, the debtor in *Eli Witt*, mirroring the spirit of LCC's objections here, argued that the future liability was "grossly exaggerated and highly speculative" and that it would be "improper to allow any part of the estimate, potential future claims because of the radically changed circumstances."[22] *Id.* at 399.

The ultimate holding in *Eli Witt* denied the administrative expense claim primarily because the court lacked the ability to estimate the speculative expenses:

> [T]he majority of the Insurance Company's administrative expense claim represents its estimation of claims it will be required to pay in the future, but will not actually have paid by

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[22] The bankruptcy proceedings in *Eli Witt* actually involved a plan of reorganization under Chapter 11, rather than a complete liquidation as eventually suffered by the Debtors here. In addition, there is a procedural difference between the two cases in that the bar date for the filing of administrative expense claims in *Eli Witt* was set pre-confirmation, while the bar date in the present matter was three months post-confirmation. In hindsight, it would appear that the approach in the *Eli Witt* bankruptcy was more advantageous because it permitted the Court to assess all administrative expense claims, and consequently the true feasibility of the plans, prior to confirming the bankruptcy plan. However, this difference in timing does not factor into the relevance of the *Eli Witt* decision vis-a-vis the case *sub judice*.

> confirmation. The Insurance Company estimates these future claims against the Debtor based on its own statistical analysis of the likelihood such claims will occur. Section 502(c) provides that contingent or unliquidated claims shall be estimated for the purpose of allowance if the liquidation would unduly delay the administration of the case. There is nothing in this record which would enable this Court to estimate these future claims, therefore, this portion of the Insurance Company's claim cannot be allowed in any amount and should be disallowed without prejudice.

Id. at 400. Zurich attempts to distinguish *Eli Witt* on numerous grounds—including lack of assumption and inducement—concluding that the case is "inapplicable to the present case."[23] It is unclear why either the Debtors' assumption of the Zurich policies or the inducement of Zurich is of legal consequence. The assumption only signifies that the debtor-in-possession effectively purchased coverage and the Debtors decision to approach Zurich for coverage during bankruptcy, rather than Zurich soliciting the Debtors, cer-

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[23] Zurich also points to the apparent reluctance by the court in *Eli Witt* to grant the administrative expense claim based only on the lack of actuarial evidence in the record sufficient to permit sound estimation. Although the "estimation" issue is addressed *infra*, it is notable that the court in *Eli Witt* did not find estimation as an appropriate exercise in the administrative expense context even though it could be argued that failure to estimate in that case could have caused "undue delay" because the claim bar date was set prior to the plan confirmation. Here, however, the bar date for the filing of an administrative expense claim was established after the plan confirmation; thus, the estimation debate would not implicate any delay in the bankruptcy administration.

tainly had no affect on Zurich's ability to refuse to provide coverage.[24]

Overall, while there is a lack of precedential guidance in this matter, notwithstanding the decision in *Eli Witt*, there is certainly not a lack of arguably analogous case law in support of both positions. These persuasive authorities generally fall into two categories. The large majority involve controversies with the temporal demarcation between pre-and post-petition that Zurich cites in support of its contention that the deductibles, although prospective, should relate back to the insurance coverage period during bankruptcy. The less prevalent group of authorities deal with scenarios post-confirmation. Although the subject-matter is a departure from the present context, LCC cites these cases in support of the general proposition that any expenses arising post-confirmation, regardless of whether they are connected to a petition-period expense, cannot by definition receive administrative priority because they do not provide a direct benefit fostering the preservation of the estate.

The collective theme from the long string of cases cited by Zurich is that, in determining what temporal designation (i.e., pre-or post-petition) should be given to expenses that are paid during bankruptcy, if the expenses arise from events or conduct that occurred prepetition then the claimed expense are not considered

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[24] In fact, Zurich points out numerous times that other insurance companies made the decision not to insure the Debtors when approached because the deal was apparently too risky a proposition. This only bolsters the logical conclusion in this case that Zurich took a calculated risk in its decision to insure the Debtors during bankruptcy and now that risk is failing to pay off.

administrative expenses because the underlying event or conduct did not itself provide a direct and substantial benefit to the estate.[25] *See, e.g., In re Highland Group*, 136 B.R. 475 (Bankr. N.D. Ohio 1992); *In re Baldwin-United Corp.*, 48 B.R. 901 (Bankr. S.D. Ohio 1985); *see also* Appellant's Opening Brief (Doc. # 12, p. 33–35). To that effect, Zurich argues that "the rationale of these cases is directly applicable to the issue in the present case—i.e., determining whether a claim arose pre- or post-effective date." Zurich concludes accordingly that because "the occurrences underlying Zurich's Claim all took place prior to the effective date, the Claim arose pre-effective date" and should receive priority treatment.

While the logic behind the line of cases dealing with pre-and post-petition scenarios makes sense in the abstract as applied to Zurich's claim since the circumstances here provide a similar time barrier (pre- and

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[25] It is this type of scenario where the value of the benefit to the estate test is realized. Under the traditional requirements of § 503, it would be difficult to assess whether expenses arising during bankruptcy but stemming from conduct pre-petition should receive administrative priority because, technically speaking, the payment of the expenses is necessary to preserve the estate from a legal perspective. However, that is not the true spirit of § 503. Therefore, the benefit to the estate test was developed to ask whether the payment of the claimed expenses would provide a direct and substantial benefit to the estate. In the current matter, the usefulness of the benefit to the estate test is questionable as discussed. Payment of clams [sic] as they arise post-confirmation could be argued to provide a benefit because the claims resulted from pre-confirmation conduct. But, pursuant to § 503, the payment of Zurich's claimed expenses would not act to preserve the estate because, as stated ad nauseam, there is no estate to preserve.

post-confirmation), such an approach does not address the purpose of granting administrative priority and is therefore of little assistance. Even if the mandate of Zurich's persuasive authority placed the "accrual" of the claimed expenses back to the bankruptcy period, despite the reality that the expenses are entirely prospective and speculative, such a finding does not alter the dispositive adjudication that the payment of the claimed expenses when they truly arise would not act to either preserve nor benefit the estate. Accordingly, administrative priority above that of an ordinary unsecured creditor is not warranted in this instance.

The second category of cases, which favor LCC's proposition that administrative expense priority is not appropriate in this matter, deal with expenses that arise or are otherwise paid post-confirmation. In this unique context, courts, although few in number, have consistently held that expenses arising post-confirmation fail to satisfy the requirements for administrative priority under § 503 for the simple, yet inescapable reality that there is no estate to preserve or benefit.

The Sixth Circuit, in an unpublished decision, succinctly rejected the counter-intuitive proposition that expenses incurred after the dissolution of an estate can be administrative:

> The logic of this conclusion becomes apparent upon an examination of the Bankruptcy Code's purpose for giving special priority to administrative expenses. Administrative expenses are given priority because they are the actual, necessary costs of preserving the estate. Because there is no need to preserve an estate that has been terminated, costs that are incurred after

> that time are not administrative expenses of the estate.

See Guy, 1992 WL 88978, at *4, 1992 U.S.App. LEXIS 10018, at *12 (citing *United States v. Redmond*, 36 B.R. 932, 934 (D. Kan. 1984)). In *Guy*, the court was charged with determining whether taxes incurred and paid after confirmation were entitled to administrative priority. Relying on the Supreme Court's holding in *Otte v. United States*, 419 U.S. 43, 95 S.Ct. 247, 42 L.Ed.2d 212 (1974), the Sixth Circuit held that the claimed expenses in *Guy* were not administrative expenses despite the fact that the wages on which the taxes were paid were earned during the bankruptcy:

> The disputed taxes in this case were on wages that were paid after the bankruptcy estate was terminated. The taxes were therefore not incurred by the estate and are not administrative expenses of the estate. The fact that the wages were earned during the pendency of the estate is simply irrelevant.... Because they were incurred by the trustee after the plan was confirmed and the estate ceased to exist, they were not incurred as the actual costs of preserving the estate and therefore cannot be construed as administrative expenses of the estate.

Id. at *4, 1992 U.S.App. LEXIS 10018, at *12–13.

When adjudicating claims for administrative priority, bankruptcy courts have consistently emphasized that priority status should be reserved for only those expenses that are critical to the administration of the bankruptcy estate. *See In re Barker Medical Co., Inc.*, 55 B.R. 435, 436 (Bankr. M.D. Ala. 1985) ("Administration of the estate ended with confirmation of the plan.

The costs were not incurred by the estate, but were incurred by the debtor after discharge and after confirmation at a time when no estate existed.... By definition, the costs cannot be administrative expenses."). Bankruptcy courts have similarly emphasized that a bankruptcy estate is a statutory creation that terminates at the effective date (i.e., confirmation) and, consequently, an estate cannot incur administrative expenses after its termination:

> It is clear that only those obligations of a debtor's estate which arise postpetition and fall within the parameters of § 503(b) are entitled to treatment as administrative expenses. Section 503 is silent as to the point in time at which the expenses of a debtor in reorganization cease to be accorded first priority administrative expense status. However, the language of § 503(b) suggests that for "actual, necessary costs and expenses" to be afforded administrative expense status, they must be incurred for "preserving the estate."
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> The filing of a Bankruptcy petition creates an estate.... In a case under Chapter 11, the estate continues until confirmation of the Plan ... at which time all of the property of the estate vests in the debtor. After that time, the estate is no longer in existence. Thus, costs and expenses incurred in a Chapter 11 case post-confirmation cannot be said to have been incurred for "preserving the estate" such that they are administrative expenses under § 503(b)(1)(A).

In re Frank Meador Buick, Inc., 59 B.R. 787, 791 (Bankr. W.D. Va. 1986) (internal citations omitted).

The district court in *Frank Meador Buick*, reviewing *de novo* the decision of the bankruptcy court below, concurred in the bankruptcy court's holding that priority status was not appropriate nor warranted. *See Dobbins v. Frank Meador Buick, Inc. (In re Frank Meador Buick)*, 65 B.R. 200 (W.D. Va. 1986). On appeal, the district court concluded that claims arising not only post-petition but also post-confirmation are not administrative expenses under the Code:

> When however, the debtor incurs costs not merely post petition but also post-confirmation they are not, and cannot, be classified as administrative expenses. After confirmation of a plan under Chapter 11, administration of the estate ends and the estate ceases to exist. Thus, it is impossible to classify taxes or rents that accrue post-confirmation as administrative expenses for the simple reason that after confirmation there is no longer an estate to administer.
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> Relying on the fact that [Debtor] incurred both the taxes and rent postpetition, [Appellant] contends that both claims are entitled to share a priority position. [Appellant] ignores that his own claim for rent, and the IRS claim for taxes, arose not merely post-petition but post-confirmation as well. As a result, neither claim may receive priority status as an administrative expense; both are ordinary creditor claims.

Id. at 203 (internal citations omitted).

The rationale and holdings of the aforementioned cases, which definitively reject the characterization of post-confirmation expenses as administrative, has been mirrored in the large majority of the remaining cases

addressing the pre-and postconfirmation scenario. *See, e.g., In re Pauling Auto Supply, Inc.*, 158 B.R. 789, 794 (Bankr. N.D. Iowa 1993) ("Inasmuch as there is no estate, a post-confirmation creditor is unable to obtain administrative status for a post-confirmation claim because there is no estate to preserve."); *In re James Frederick Severson*, 53 B.R. 8, 10 (Bankr. D. Or. 1985) ("For losses or expenses incurred after [confirmation], there could be no claim allowable under § 503(b)(1)(A) as an expense of preserving the estate since no estate existed after that date."). Accordingly, it is clear that the case law applicable to the circumstances *sub judice*, although not directly on point on either side of the debate, strongly favors the conclusion of this Court that expenses incurred post-confirmation are not entitled to priority treatment as administrative in nature.

C. Other (Non–Dispositive) Considerations

1. Estimation of Expenses

Because the Code does not explicitly authorize estimation of expenses in the administrative claim context, the parties have addressed the question of whether the Code even permits estimation (i.e., § 503 requires expenses to be "actual") and what form of estimation would prove sufficient if permitted.[26] The Bankruptcy Court below was "not convinced that esti-

[26] LCC argues that advancing Zurich the prospective deductible obligations not only exceeds the scope of the Bankruptcy Court's authority under § 503, but allowing administrative priority would circumvent the contractual expectations of the parties and is tantamount to breach of contract because the legal obligation to reimburse Zurich for deductible advancements does not accrue until Zurich is forced to pay the potential claims as they actually arise in the future.

mation is even proper in this instance." As the court explained, estimation of claims is only an approved method of winding up under § 502(c) for "any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case." 11 U.S.C. § 502(c).

The large majority of courts addressing estimation have consistently held that, because § 502 covers prepetition claims of general creditors, the allowance for estimation of claims under § 502(c) is reserved only for claims falling within the scope of § 502. *See In re Indian Motocycle Co.*, 261 B.R. 800, 810 (1st Cir. BAP 2001) ("[W]e have not found a single case which has estimated a debtor's postpetition administrative tax claim pursuant to § 502(c)."). Administrative expense claims, however, fall under the § 503 priority scheme for administration of the bankruptcy estate, which immediately calls into the question the availability of § 502(c) estimation for administrative claims. Presumably, estimation of post-petition claims was not cognized by § 502(c) because such claims are the exclusive domain of § 503.

Although very few courts have addressed the issue of estimating administrative expense claims under the authorization of § 502(c), the bankruptcy court of the Eastern District of Virginia explicitly rejected the idea that § 502(c) could act to authorize estimation for administrative claims that inherently fall under § 503:

> There are differences between requests for payment [of an administrative expense] and proofs of claim. One relates to allowance. A proof of claim is deemed allowed unless a party in interest objects to the claim. A properly filed proof of claim constitutes prima facie evi-

> dence of the validity and amount of claim. A contingent or unliquidated claim may be estimated under § 502(c) if the fixing or liquidation of the claim would unduly delay the administration of the estate. None of these provisions apply to a request for payment [of an administrative expense claim]. The burden of proof for the request is on the claimant. There is no comparable provision for estimating contingent or unliquidated administrative expenses. In fact, administrative expenses are required to be "actual, necessary costs and expenses of preserving the estate."

In re Atcall, Inc., 284 B.R. 791 (Bankr. E.D. Va. 2002) (internal citations omitted).

Furthermore, the First Circuit's Bankruptcy Appellate Panel, addressing the analogous problem of estimating administrative tax liability claims, held that estimation was not proper through the use of § 502(c) where not otherwise authorized:

> We find that the bankruptcy court erred by applying § 502(c) to estimate the post-petition tax liability of the Debtors.... We are convinced that the proper statutory construction requires that administrative tax liability be determined according to the provisions of § 505.... To the extent there is an argument that the general language of § 502(c) may be stretched to cover even postpetition claims, we follow the established rule of statutory construction that a more specific statute covering a particular subject is controlling over a statutory subject in more general terms.

In re Indian Motocycle Co., 261 B.R. at 809–10 (internal citations omitted). Accordingly, in light of the purpose and scope underlying the allowance for administrative expense priority under the Code and the requirement that expenses be "actual" pursuant to § 503, the use of § 502(c) estimation for § 503 administrative expenses is counter-intuitive and the authority to do so seems lacking under the circumstances.[27]

2. Policy Concerns

Zurich has vowed that disallowing its claim for administrative expense priority will effectively turn the bankruptcy and insurance worlds "upside down." The concern, however genuine, is that insurance companies will no longer insure debtors during bankruptcy if the prospective deductibles are not characterized as administrative expenses because that will place an excessive amount of risk on the shoulders of the insurance company—risk that the utilization of a deductible policy is intended to offset. Zurich maintains that guaranteed cost policies, those without deductible obligations, would be far too expensive for the financially-strapped companies to afford. And if debtors are therefore unable to secure insurance coverage during bankruptcy, this would in turn prevent the continuing operation of most debtors-in-possession. Consequently, the end result is the supposed devaluation of the estate to the detriment of all creditors thereof.

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[27] Perhaps estimation only would, or even should, be necessary where the administrative claim bar date is set prior to the confirmation date (*see, e.g., Eli Witt*) in order to estimate the claims that may arise between the bar date and confirmation date, which was not the case here.

The value that insurance coverage provides to debtors-in-possession during bankruptcy cannot be overstated. *See Reading*, 391 U.S. at 483, 88 S.Ct. 1759 ("It is of course obvious that proper insurance premiums must be given priority, else insurance could not be obtained; and if a receiver or debtor in possession is to be encouraged to obtain insurance in adequate amounts, the claims against which insurance is obtained should be potentially payable in full.") Nevertheless, the precedential repercussions felt by denying Zurich's claim under these narrow circumstances will not produce the dire picture that Zurich now paints.

The parties acknowledge that the current controversy stems largely from the failure of the Frontier collateral utilized as security for the projected deductible losses. In business terms, therefore, the pertinent question is who should bear the risk realized—the Debtors (now represented by LCC) because the prospective deductibles will be legal obligations as they arise, or should Zurich absorb the loss because it failed to adequately assess the risk and protect its interests? The answer is reached by the simple realization that the question before the Court is not whether Zurich should be reimbursed for the deductibles where incurred in the future (as a creditor of the now-defunct estate), but instead whether Zurich's claim for prospective expenses should receive administrative priority treatment. Proverbially speaking, Zurich made its bed and the other parties in interest—including LCC and the public by way of reclamation—should not be forced to sleep in it.

Zurich argues that it simply assumed that receiving administrative expense priority treatment for the loss projections was a foregone conclusion and that it relied upon this presumed reality when negotiating

with the debtors-in-possession. However, this raises the rather conspicuous question of why Zurich would require extensive collateral from the debtor-in-possession if receiving administrative expense priority was never a problem in past cases. The June 25, 2004 Amended Order explicitly stated that Zurich retained the right to file an administrative claim for loss projections not covered by the collateral and that the Debtors (now represented by LCC) retained the right to object to any such claim:

> The projected total liability by the Debtors that will be due and owing to Zurich over the lifetime of the payments under the Insurance Contracts is in excess of $10,000,000, and Zurich retains the rights to assert an administrative claim for the balance of any claims under the Insurance Contracts. The Debtors reserve the right to object to any additional administrative claim asserted by Zurich.

While this evinces knowledge by both parties and the Bankruptcy Court that an administrative claim by Zurich was possible and perhaps even likely, it also demonstrates that Zurich had no guarantee of receiving administrative priority for the prospective deductible obligations. A sense of entitlement may have existed as to any premium and deductible obligations arising pre-confirmation or pre-effective date, but despite Zurich's plea otherwise, there is nothing in the record that demonstrates justifiable reliance on the part of Zurich as to the prospective and speculative obligations post-confirmation.

Furthermore, Zurich's efforts to obtain adequate collateral to protect its interests, despite the alleged belief that it would receive priority payment of the loss

projections regardless, ironically demonstrates not only that Zurich did not justifiably rely on receiving priority status, but also that the consequences of denying Zurich's administrative expense claim in this instance will not have a material effect on either the process or the prospects of insurance coverage during bankruptcy. In other words, seeing as Zurich attempted to secure sufficient collateral to cover its risk and that this case arose due to the rare instance of the collateral proving insufficient, there is nothing to suggest that future parties will not continue to negotiate collateralization of deductible risks. Perhaps even greater collateralization will become necessary to insure against the result Zurich now faces, but that can be viewed as a positive development and in no way necessitates the prohibitive use of guaranteed cost policies when insuring debtors-in-possession.

Finally, despite the fact that Zurich places great weight on the allegation that the Debtors induced Zurich to provide ongoing coverage during bankruptcy, the practical reality remains that Zurich is an incredibly sophisticated, for-profit insurance corporation that was fully aware of the risks associated with insuring a financially-troubled business. The parties concede that this controversy would not be at issue but for the unfortunate failure of a substantial portion of the collateralizing bonds to pay off.[28] As such, because the cover-

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[28] Adding to the overall speculative nature of Zurich's claim is the uncertainty that still surrounds the allegedly defunct Frontier bonds that provided for partial collateralization of the deductible obligations under the Zurich policies. In essence, Zurich is requesting accelerated payment for prospective deductible expenses without affirmative (i.e., "actual") knowledge that the problem

age agreements in this case were reached at arm's length and contentiously negotiated by parties of unquestionable competence, any alleged inducement is of no legal significance and the Court will not disturb the contracts here simply because one party may have more adamantly approached the other to do business.

3. Participation in Plan Feasibility

LCC asserts that Zurich's failure to object to the confirmation of the Debtor's Plan proves "fatal" to its administrative claim despite Zurich's timely submission of its claim within the established bar date for priority claims. The Bankruptcy Court below focused on Zurich's failure to "participate" but it is unclear whether the determination was necessary to the court's ultimate decision to deny Zurich's claim or merely an additional area of consideration that may justify the adverse ruling against Zurich. The Bankruptcy Opinion notes that because Zurich was not sufficiently involved in the process, if at all, it deprived the parties in interest from accounting for Zurich's massive administrative claim in assessing the ultimate feasibility of the Debtors' Plans:

> As Lexington Coal points out, Zurich chose not to participate in the plan process until after the Plans had been confirmed. The creditors and other parties in interest in this case were thus necessarily deprived of the opportunity to factor in a huge administrative expense claim that would have had a major effect on the consideration of the feasibility of the Debtors' proposed Plans. Lexington Coal asserts that Zu-

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bonds will not adequately cover the obligations or what those obligations will prove to be.

> rich should have participated in the Debtors' cases and requested an estimation of its administrative expense claim prior to the confirmation process. It further asserts that Zurich's request for estimation is neither appropriate nor timely under these circumstances. This court agrees.

In re HNRC Dissolution Co., 343 B.R. at 845.

Whether or not Zurich should have participated in the feasibility process, a question which is almost rhetorical in hindsight, it is clear that Zurich was not required to do so. The Bankruptcy Court established a bar date for administrative claims that ran three months past confirmation; Zurich's claim was timely in that regard. Both parties and the court had notice that an administrative claim by Zurich was at the very least a possibility due to the mention of such in the June 25, 2004 Amended Order that reserved a right to Zurich to file the claim and the attending right of the Debtors to object.

Although it would now appear that Zurich's failure to participate in the bankruptcy was done so potentially to its detriment, there is no guarantee that its participation would have altered the feasibility of the Debtors' Plans because the collateralization of the claimed expenses was believed to be adequate at that juncture.[29] Regardless, while Zurich's absence from the bankruptcy may ultimately prove fatal to its prospects of

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[29] Zurich noted that at the time it filed its administrative expense claim, which was several months beyond the feasibility stages, that the decision to file was merely a protective measure taken to ensure that the deductible obligations would be paid if the collateral proved insufficient.

recovering the prospective deductible obligations practically speaking, Zurich's absence does not prove fatal to its claim for administrative expenses from a legal standpoint.

IV. CONCLUSION

In accordance with the foregoing analysis, and the Court being otherwise sufficiently advised, **IT IS ORDERED** that the Bankruptcy Court's denial of Zurich's application for allowance of an administrative expense claim on prospective deductible obligations under the Zurich Policies be, and hereby is, **AFFIRMED**.

It is further **ORDERED** that this matter is **stricken** from the active docket of the Court. This is a **final** and **appealable** order.

MEMORANDUM ORDER

I. Introduction

This matter is before the Court on Appellant Zurich's Motion to Stay this Court's July 2, 2007 Memorandum Opinion and Order pending appeal (Doc. # 47). Appellee Lexington Coal Company ("LCC") having filed its response in opposition to the motion (Doc. # 53), and Zurich having filed its reply (Doc. # 57), the motion is ripe for the Court's review.

In its motion, filed pursuant to Federal Rule of Appellate Procedure 8(a), Zurich seeks to have the Court stay its prior decision which affirmed the Bankruptcy Court's Order denying administrative expense priority status to Zurich's claims. In essence, Zurich seeks to preserve the status quo regarding the previously stayed administrative expense pool, estimated at 16.2

million dollars[1], pending appeal so that it may reap the benefit of a potentially meritorious appeal. More specifically, Zurich continues its multi-faceted attack on this Court's July 2, 2007 decision, arguing that the four factor test set forth in *Mich. Coal. of Radioactive Material Users, Inc. v. Griepentrog*, 945 F.2d 150 (6th Cir. 1991) warrants the requested stay. LCC argues that the balancing of the four factors weighs against the issuance of a stay.

After carefully considering the record, the controlling law, as well as the parties' briefs and arguments, the Court concludes that a stay pending appeal is not warranted herein. Accordingly, the motion for a stay is **denied**, and the Court will not stay the Memorandum Opinion and Order Zurich is appealing.

II. Discussion

In determining whether a stay should be granted under Rule 8(a) of the Federal Rules of Appellate Procedure, the court considers the same four factors that are traditionally considered in determining whether to grant a preliminary injunction. *Griepentrog*, 945 F.2d at 153; *Hilton v. Braunskill*, 481 U.S. 770, 776, 107 S.Ct. 2113, 95 L.Ed.2d 724 (1987). These factors are the following: 1) the likelihood that the party seeking the stay will prevail on the merits of the appeal; 2) the likelihood that the moving party will be irreparably harmed absent a stay; 3) the prospect that others will be harmed if the court grants the stay; and 4) the public interest in granting the stay. *Griepentrog*, 945 F.2d at 153. Although the court considers these same four factors for both a motion to stay pending appeal and a preliminary

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[1] This amount is based upon the representation of LCC's counsel at oral argument. (Doc. # 45 at p. 20).

injunction, the weight given to each of these factors is not necessarily the same. *Id.* A movant seeking a stay on appeal, for example, will be less likely to establish the probability of success on the merits than one who petitions for a preliminary injunction. *Id.* Conversely, a movant seeking a stay on appeal will have a greater likelihood of establishing irreparable harm than one who seeks a preliminary injunction. *Id.* In either case, however, the moving party has the burden of showing a combination of these factors to persuade the court to grant their motion.

In evaluating the degree of injury, it is important to remember that the key word in this consideration is *irreparable.* Mere injuries, however substantial, in terms of money, time and energy necessarily expended in the absence of a stay, are not enough. The possibility that adequate compensatory or other corrective relief will be available at a later date, in the ordinary course of litigation, weighs heavily against a claim of irreparable harm. *Sampson v. Murray,* 415 U.S. 61, 94 S.Ct. 937, 39 L.Ed.2d 166 (1974).

In its motion, Zurich raises the same legal challenges it raised in its previously filed appellate brief, to wit, that the Bankruptcy Court, and now this Court, erred as a matter of law in concluding that its claim was not entitled to administrative expense priority status pursuant to 11 U.S.C. § 503 and applicable case law. While couched in a motion to stay, Zurich raises no new arguments or cites no new authority that raises the specter of a reversal on appeal.[2]

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[2] In denying the pending motion for stay, the Court is mindful that a motions panel of the Sixth Circuit Court of Appeals may be called on to review the denial on an expedited basis. The Court

Here, the Court is unconvinced that the character of the potential injuries described in Zurich's motion and reply is truly irreparable so as to justify the extraordinary relief sought. In its motion, Zurich states that "if the [Memorandum Opinion and] Order is not stayed pending appeal, LCC might distribute funds held in reserve that would be used to satisfy Zurich's administrative claim" (Doc. # 47 at p. 8). Zurich's claim for administrative expense priority status, at its core, is one for monetary recovery. The monetary harm that Zurich would allegedly suffer if the stay was denied does not constitute irreparable harm. *See Sampson v. Murray*, 415 U.S. 61, 90-91, 94 S.Ct. 937, 39 L.Ed.2d 166 (1974) (holding that monetary damages do not generally constitute irreparable harm).

In this case, it is undisputed that the confirmation plans allowed for LCC to use the funds in the administrative expense pool to fund its reclamation and related activities. Although there was a recognition during the bankruptcy proceedings that Zurich would be submitting an administrative expense claim, the parties acknowledged during oral argument that the administrative expense pool may be used to fund reclamation projects. Not only was using the funds in the pool for reclamation purposes expressly provided for by the bankruptcy court, such use going forward is entirely permissible. Although the parties were unable at oral argument to provide exact figures for the costs of such

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also recognizes that the issues likely to be raised on appeal were relatively unsettled issues of law, which will be reviewed de novo. These points notwithstanding, for the reasons set forth in the July 2, 2007 Memorandum Opinion and Order, the Court believes that Zurich has failed to satisfy its burden of showing a likelihood of reversal on appeal.

reclamation projects, the fact that the amount is unknown bolsters a finding of no irreparable harm to Zurich. Thus, although Zurich believes the administrative expense pool will be entirely depleted if a stay is not granted during the pendency of the appeal, Zurich's argument is speculative on this point. Finally, although Zurich argues it is merely seeking to avoid having the funds in the pool distributed to class claimants with lower priority, if the stay were granted, other administrative expense claimants with the same priority would be potentially deprived of the funds.

The third and fourth *Griepentrog* factors also favor a denial of the motion to stay. Although Zurich argues that LCC has reserved adequate funds to pay its administrative expense claim if allowed, it was the bankruptcy court, as opposed to LCC, which reserved funds to pay administrative expense claims. The freezing of the administrative expense pool during the pendency of the appeal, for the sole benefit of Zurich, is inconsistent with the orders of the bankruptcy court which established the pool as part of the confirmation of the plans. As set forth by LCC in its response, several state and federal regulatory entities withdrew their objections to the confirmation plans based on the bankruptcy court's order setting aside funds in the administrative expense pool for reclamation purposes. To usurp that order now will potentially harm those parties by depriving them of funds set aside for their purposes. The administrative expense funds should be permitted to be used in accordance with the purposes for which they were set aside. Granting the requested stay would be contrary to those specifically negotiated purposes. Finally, the public interest in the finality of confirmed plans in bankruptcy and the orderly administration of bankruptcy cases outweighs any stated interest by Zurich.

III. Conclusion

Because Zurich has not satisfied the requirements for a stay pending appeal,

IT IS ORDERED that Zurich's Motion for a Stay (Doc. # 47) be, and is hereby **DENIED.**

APPENDIX C

In re HNRC DISSOLUTION CO., f/k/a Horizon Natural Resources Company, et al., Debtor.

No. 02-14261.

United States Bankruptcy Court,
E.D. Kentucky, Ashland Division.

May 30, 2006.

MEMORANDUM OPINION

WILLIAM S. HOWARD, Bankruptcy Judge.

1. *Introduction*

Lexington Coal Company, LLC ("Lexington Coal"), one of the purchasers of assets of the former Debtors, has objected to the application for allowance of administrative expense filed by Zurich American Insurance Company ("Zurich"). Lexington Coal filed its original objection (Doc. # 5492, "the Objection") on February 18, 2005. An Agreed Scheduling Order (Doc. # 6467) was entered on June 30, 2005. Pursuant to the terms of that order, Lexington Coal filed a Supplemental Objection (Doc. # 6646) on July 29, 2005. Zurich filed a Response to Supplemental Objection (Doc. # 6853, "the Response") on August 31, 2005, and Lexington Coal filed a Reply to Response to Supplemental Objection (Doc. # 6918, "the Reply") on September 15, 2005.

The matter was first taken under submission by entry of an Order of Submission (Doc. # 6997) on October 14, 2005, but on November 21, 2005 the court entered an order requiring the parties to tender joint stipulations and a list of exhibits (Doc. # 7071). The

Joint Stipulation and List of Exhibits (Doc. # 7180) was filed on January 24, 2006, and an Order of Submission (Doc. # 7232) was entered on February 21, 2006. This matter is now under consideration for decision.

2. *Factual and procedural background*

The parties have entered into extensive joint stipulations which are incorporated herein by reference. The facts set out below are consistent with those stipulations.

On December 29, 2004 Zurich filed an Administrative Expense Request Form designated Claim No. 20675 seeking an administrative expense claim in the amount of $44,744,067.00 ("the Claim"). The Claim is based on alleged post-petition deductible losses under insurance contracts with Zurich and two of its affiliated companies, American Zurich Insurance Company ("American Zurich") and Steadfast Insurance Company ("Steadfast"), that were assumed by the Debtors for workers' compensation, commercial auto, and general liability coverage. Zurich did not enter an appearance in the Debtors' cases. Neither Lexington Coal nor any of the other purchasers of the Debtors' assets assumed the Zurich policies.

The Claim is made up of: (i) the Administrative Expense Request Form, (ii) an Addendum to Administrative Expense Request Form ("the Addendum"), (iii) Exhibit A, titled "The Insurance Contracts," and (iv) Exhibit B, titled "Collateral Charge Summary." The Addendum states the Claim was filed "as a protective measure to ensure payment of administrative expenses incurred by Zurich in the event that the surety bonds and other security provided by the Debtor to Zurich to secure payment of insurance deductibles owed by the Debtors to Zurich are ultimately dishonored."

The Collateral Charge Summary relates to a "Current Ultimate Loss Projection" totaling $46,858,757.00, which Zurich attached to its Response. The Claim does not provide the underlying estimates, calculations and/or actuarial assumptions that were used to arrive at the Ultimate Loss Projection. Ultimate loss projections are actuarial projections requiring actuarial judgment which are used to forecast total deductible liability on policies where the insured has agreed to be responsible for such liabilities and such liability extends into the future. This is especially true for workers' compensation coverage which can extend years past policy expiration. In connection with the Program, Zurich and the Debtors entered into separate Deductible Agreements governing the terms and conditions for payment of deductible amounts on claims under workers' compensation policies.

Zurich's history of billings to the Debtors for paid losses, paid expenses and premiums is shown in statements of account. These do not include reserves that have been set by Zurich, or claims that have been incurred but not yet reported. Actuaries do not use the figures contained in the statements of account to determine the Ultimate Loss Deductible. Zurich's billing system has two components, premium billing and deductible billing. Neither has any direct relevance to the calculation of ultimate loss projections except to the extent that paid deductible bills are deducted from the ultimate loss in calculating the net outstanding ultimate deductible loss.

On September 5, 2003, the Debtors filed their Motion for Order Authorizing Assumption of Certain Insurance Contracts ("the Motion to Assume," Doc. # 1785). On September 23, 2003, the court entered the Order Granting Motion of Debtors for Order Authoriz-

ing Assumption of Certain Insurance Contracts ("the Assumption Order," Doc. # 1860). Pursuant to the Assumption Order, the Debtors assumed the "Program" and "Contracts" in the Motion to Assume. The policies to be assumed were described in Exhibit A to the Motion to Assume. Zurich attached a list of applicable policies to the Claim. That list is identical to the list attached to the Motion to Assume. The "Program" was defined in the Motion to Assume as Zurich's provision of workers' compensation, business automobile, general liability and other coverages as part of an insurance program for the Debtors, their predecessors and affiliates, along with related deductible agreements.

Earlier in 2003 the Debtors negotiated a renewal of their coverage with Zurich. Zurich had made known its perceived need for additional collateral. Zurich originally sought $15 million, but eventually agreed to accept collateral in the amount of $10 million. Zurich agreed to receive this amount following the effective date of what was then going to be a plan of reorganization. The payment date was changed when the Debtors sold all their assets and ceased to exist. As of September 2003, when the Debtors assumed the Program and the Contracts, they had paid all amounts Zurich had billed to them, but had not paid a renewal premium.

All of the Debtors' insurance coverage was subject to renewal on June 29, 2004. Zurich chose not to renew the insurance policies as it had the right to do under the policies' terms. Zurich and the Debtors then negotiated terms for extending the coverage period. On June 25, 2004, the court entered the Stipulation and Amended Order Authorizing Assumption of Insurance Contracts ("the Amended Order", Doc. # 3381). The footnote on Exhibit A to the Amended Order states: "Upon information and belief, this [policy] list includes all policies

to be assumed pursuant to this Agreed Amended Order. However, the Debtors reserve the right to amend or supplement this list from time to time." The policies listed are identical to those listed with the Motion to Assume.

Footnote 3 of the Amended Order states: "The projected total liability of the Debtors that will be due and owing to Zurich over the lifetime of the payments under the Insurance Contracts is in excess of $10,000,000, and Zurich retains the right to assert an administrative claim for the balance of any claims under the Insurance Contracts. The Debtors reserve the right to object to any additional administrative claim asserted by Zurich." The annual policies would have expired on June 28, 2004, but the Amended Order allowed for extensions on a month-to-month basis. The final extension expired on September 28, 2004 at midnight.

3. *Discussion*

Requests for administrative expenses are authorized under Bankruptcy Code section 503. Section 503(b) provides in pertinent part, "[A]fter notice and a hearing, there shall be allowed administrative expenses, ... including ... the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1)(A). In order to qualify as an "actual, necessary" administrative expense, a debt must have arisen from a post-petition transaction with the debtor, and have directly and substantially benefitted the estate. *In re Sunarhauserman, Inc.*, 126 F.3d 811, 816 (6th Cir. 1997) provides a two-part analysis in applying this provision:

> [A] debt qualifies as an 'actual, necessary' administrative expense only if (1) it arose from a transaction with the bankruptcy estate and (2) directly and substantially benefitted the estate.

> The benefit to the estate test limits administrative claims to those where the consideration for the claim was received during the post-petition period.

Id. at 816. A claimant has the burden of proving entitlement to an administrative expense by a preponderance of the evidence. Further, "[t]he claimant must demonstrate that the benefit is more than a speculative or potential benefit." *In re Kmart Corp.*, 290 B.R. 614, 621 (Bankr. N.D. Ill. 2003).

> [T]here must be a strict construction of the terms 'actual' and 'necessary' therefore requiring that the estate actually receives a real benefit from the transaction, before administrative priority will be granted on claims against the estate.... The focal point of the allowance of a priority is to prevent unjust enrichment of the estate, not to compensate the creditor for its loss.... Thus, a court looks to the actual benefit to the estate and not the loss sustained by a creditor.

In re Globe Metallurgical, Inc., 312 B.R. 34, 40 (Bankr. S.D.N.Y. 2004) (internal quotes and citations omitted). *See also In re WorldCom, Inc.*, 308 B.R. 157 (Bankr. S.D.N.Y. 2004).

A debt is not entitled to administrative expense priority treatment simply because the right to payment arises postpetition; the claimant must demonstrate the benefit that inured to the estate. *In re Highland Group, Inc.*, 136 B.R. 475 (Bankr. N.D. Ohio 1992); *In re Amarex*, 853 F.2d 1526, 1530 (10th Cir. 1988). Administrative expenses are generally allowed only after they have been incurred. *In re Microfab, Inc.*, 105 B.R. 161, 170 (Bankr. D. Mass. 1989). Expenses incurred post-

confirmation are not entitled to administrative expense priority treatment. As stated by the court in *In re Frank Meador Buick, Inc.*, 65 B.R. 200 (W.D. Va. 1986),

> When, however, the debtor incurs costs not merely post petition but also postconfirmation they are not, and cannot, be classified as administrative expenses. After confirmation of a plan under Chapter 11, administration of the estate ends and the estate ceases to exist. *In re Barker Medical Company, Inc.*, 55 B.R. 435, 436 (Bankr. M.D. Ala. 1985). Thus, it is impossible to classify [costs] that accrue post-confirmation as administrative expenses for the simple reason that after confirmation there is no longer an estate to administer. *See United States v. Redmond*, 36 B.R. 932, 934 (D. Kan. 1984[)], *aff'g, In re Westholt Mfg., Inc.*, 20 B.R. 368 (Bankr. D. Kan. 1982).

Id. at 203. *See also Guy v. Terex Corp.*, No. 91–3687, 1992 WL 88978 (6th Cir. April 30, 1992). Zurich has not provided any authority for its proposition that a claimant is entitled to administrative expense priority for claims that arise after the confirmation of a plan and after the estate ceases to exist.

A casualty loss claim such as would be paid under a Zurich policy must have arisen from a post-petition accident or occurrence, and the claim must actually be paid prior to confirmation in order to qualify as an administrative expense. *See In re Eli Witt Co.*, 213 B.R. 396 (Bankr. M.D. Fla. 1997), in which the debtor's workers' compensation insurer made an administrative expense claim for deductibles which would be payable in the future. The court stated:

> [T]he majority of the Insurance Company's administrative expense claim represents its estimation of claims it will be required to pay in the future, but will not actually have paid by confirmation. The Insurance Company estimates these future claims against the Debtor based on its own statistical analysis of the likelihood such claims will occur. Section 502(c) provides that contingent or unliquidated claims shall be estimated for the purpose of allowance if the liquidation would unduly delay the administration of the case. There is nothing in this record which would enable this Court to estimate these future claims, therefore, this portion of the Insurance Company's claim cannot be allowed in any amount and should be disallowed without prejudice.

Id. at 400. The court in *In re Oread, Inc.*, 269 B.R. 871 (Bankr. D. Kan. 2001), employed similar reasoning:

> Because granting administrative expense status requires that the claim arise from providing an actual benefit, the court in *Eli Witt* disallowed estimated amounts claimed by the insurer for injuries suffered in both prepetition and postpetition accidents. Even for injuries suffered in postpetition accidents, if the claim had not been presented by the time of plan confirmation, it could not be characterized as an actual claim, necessary to the preservation of the estate. The court further noted that the record was devoid of evidence by which these yet to be presented claims could be estimated for purposes of allowance under § 502(c), apparently rejecting the insurer's statistical analysis of the likelihood of such claims.

Id. at 879.

Zurich contends that these holdings actually support its claim for administrative expense treatment of post-confirmation deductible payments because the *Eli Witt* court disallowed the claims for payment of future deductibles without prejudice. From this Zurich extrapolates a determination that such claims are necessarily payable as administrative expenses. At this point, Zurich has provided nothing more than "its own statistical analysis of the likelihood such claims will occur" for the purpose of estimating its claim, and the court finds such analysis no more supportive of its claim than the *Eli Witt* court did. The court does not see how Zurich can ever provide anything more than a statistical analysis until the events that precipitate a claim for deductibles occur. These events, by necessity, will occur post-confirmation.

Further, the court is not convinced that estimation is even proper in this instance. Estimation of claims under section 502(c) is performed "for purpose of allowance under this section." 11 U.S.C. § 502(c). Requests for payment of administrative expenses are not made pursuant to section 502. A form of estimation of claims may take place in the context of post-petition claims. *See In re MacDonald*, 128 B.R. 161, 167 (Bankr. W.D. Tex. 1991). However, as pointed out in *In re Indian Motocycle Co., Inc.*[1], 261 B.R. 800 (1st Cir. BAP 2001), the *MacDonald* court recognized that section 502(c) "....facially applies only to pre-petition claims. Post-petition claims are governed by [§] 503." *Id.*, quoting

[1] The debtor's name is reported as "Indian Motocycle Co., Inc." The history of the case shows that in other instances it was reported as "Indian Motorcycle Co., Inc."

In re MacDonald, 128 B.R. at 165. The *Indian Motocycle* court went on to observe that the *MacDonald* court had found that "the **estimation procedures of § 502(c) might be appropriate to evaluate the feasibility of a Chapter 11 plan.**" *Id.* at 810 (emphasis added). The holding that estimation might be appropriate for evaluating the feasibility of a Chapter 11 plan is instructive in that it places administrative expense claims where they belong, i.e., in the post-petition, pre-confirmation period of estate administration.

As Lexington Coal points out, Zurich chose not to participate in the plan process until after the Plans had been confirmed. The creditors and other parties in interest in this case were thus necessarily deprived of the opportunity to factor in a huge administrative expense claim that would have had a major effect on the consideration of the feasibility of the Debtors' proposed Plans. Lexington Coal asserts that Zurich should have participated in the Debtors' cases and requested an estimation of its administrative expense claim prior to the confirmation process. It further asserts that Zurich's request for estimation is neither appropriate nor timely under these circumstances. This court agrees.

In consideration of all the foregoing, it is the opinion of this court that Zurich's application for allowance of administrative expense should be denied. An order in conformity with this opinion will be entered separately.

APPENDIX D

In re HNRC DISSOLUTION COMPANY, formerly known as Horizon Natural Resources Company, et al., Debtors.

Zurich American Insurance Company, Appellant,

v.

Lexington Coal Co., LLC, Appellee.

No. 07-5894.

United States Court of Appeals,
Sixth Circuit.

[STAMP: FILED
Jan 08, 2009
LEONARD GREEN, Clerk]

ORDER

BEFORE: ROGERS and MCKEAGUE, Circuit Judges; and ADAMS,* District Judge.

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

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* Hon. John R. Adams, United States District Judge for the Northern District of Ohio, sitting by designation.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE COURT

/s/ Leonard Green

Leonard Green
Clerk

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No.08-1254

In the Supreme Court of the United States

ZURICH AMERICAN INSURANCE COMPANY,
Petitioner,

v.

LEXINGTON COAL COMPANY, LLC,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

OPPOSITION TO A WRIT OF CERTIORARI

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May 29, 2009

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QUESTION PRESENTED

The United States Bankruptcy Code allows a limited priority of payment to certain claims accruing during the administration of a bankruptcy case, generally referred to as administrative expense claims. 11 U.S.C. §§ 503(b)(1)(A) and 507(a). Priority treatment requires proof that claims are "actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1)(A). This case involves a program of insurance that is unique to the petitioner/insurer and the debtors/insureds. The insurance contracts obligated the petitioner to administer workers' compensation claims, and pay claims if required, before the debtors had any obligation to reimburse the insurer for the deductible portion of the insurance policies. The narrow question presented by this case is whether the petitioner may, contrary to the terms of the insurance contracts, force the immediate payment of an estimate of deductibles that might or might not arise after the termination of the debtors' bankruptcy estates as an administrative expense.

RULE 29.6 DISCLOSURE STATEMENT

Respondent Lexington Coal Company, LLC, a Delaware limited liability company, is not a subsidiary or affiliate of a publicly held company. No publicly owned company owns 10% or more of the membership interests of Lexington Coal Company, LLC.

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TABLE OF AUTHORITIES

STATEMENT

Under the Bankruptcy Code certain claims that accrue during the administration of a bankruptcy case, generally referred to as administrative expense claims, are given priority treatment pursuant to 11 U.S.C. §§ 503(b)(1)(A) and 507(a). Priority treatment requires proof that claims are "actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1)(A). The "rare" and "very narrow" issue presented in this case involves an administrative expense claim dispute between petitioner and claimant, Zurich American Insurance Company, and respondent, Lexington Coal Company, LLC. Respondent has the right to object to and resolve all administrative expense claims in the bankruptcy proceeding of the debtors, Horizon Natural Resources Company and subsidiaries ("Debtors"). At issue is whether an estimate of unknown and unpaid deductibles that will arise only after termination of Debtors' bankruptcy estates are "actual" and "necessary" to the preservation of the Debtors' bankruptcy estates.

The "bankruptcy estate" is a creature of statute that comes into existence upon the commencement of the bankruptcy case. *See* 11 U.S.C. § 541(a). Debtors filed their petitions on November 13 and 14, 2002. Consummation of Debtors' Plans[1] and

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[1] In its Petition for a Writ of Certiorari, petitioner only refers to a "plan" confirmed in the underlying bankruptcy cases. Debtors actually confirmed two plans (jointly, the "Plans"): (i) Third Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code and (ii) Third Amended Joint Plan of

dissolution of Debtors' bankruptcy estates occurred on September 30, 2004 (the "Effective Date"). App. 2a, ¶ 83.[2] Therefore, Debtors' estates existed and were administered from November 13 or 14, 2002, to September 30, 2004 (referred to herein as the "administration period").

1. It is undisputed that Debtors owed and paid petitioner all premium and deductible obligations due under insurance contracts assumed as part of a program of insurance during the administration period. Pet. App. 23a-24a. The parties dispute, however, whether petitioner may unilaterally amend the insurance contracts to accelerate the obligation of the Debtors to pay deductibles for future workers' compensation claims that had not yet accrued at the time of confirmation through a request to treat an estimate of such amounts as an administrative priority expense. These estimated claims were neither made (by the covered worker) nor paid (by petitioner) at the time of termination of the administration period.

Petitioner provided the insurance coverage to Debtors through the issuance of numerous annual insurance policies from 1998 to approximately the

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Liquidation Under Chapter 11 of the Bankruptcy Code. The Plans set out specific rights and obligations of interested parties, including respondent, but did not provide for any post-confirmation payment to petitioner.

[2] Relevant Excerpts from the Agreed Stipulated Facts and List of Exhibits of Zurich American Insurance Company and Lexington Coal Company, LLC [Doc. 7180] is attached as Appendix A for ease of reference (the "Stipulated Facts").

Effective Date. Petitioner referred to the relationship as a "Program" to reflect the nature of the obligations of the parties, which were in addition to, and went beyond, the purchase of insurance coverage. The majority of the insurance policies under the Program related to workers' compensation coverage. App. 4a, ¶ 138. "Under the Zurich Program, the insureds were not obligated to pay the deductible in full upon the occurrence of the claim. Instead, Zurich would advance money to pay losses and expenses, and the insureds would not pay until billed." *See* R. 9, Motion to Stay, at 3, App. 62.

This type of insurance policy, known as a deductible policy, exposes the insurer to the risk that the insured will become insolvent and have no ability to pay the deductibles, even though the insurer will remain obligated to pay covered workers in full. The insurer typically negotiates for collateral to protect against that risk. The insurer and insured may negotiate over the amount and nature of the collateral and competing insurance companies may offer the insured different terms concerning both rates and collateral. Pet. App. 10a-11a.

In keeping with industry practice for deductible policies, petitioner obtained substantial collateral from Debtors to cover the exposure it now seeks to address through an administrative expense priority claim. This collateral includes cash exceeding $23 million and almost $14 million in surety bonds. Pet. App. 20a and 21a, n. 13. When the insurance policies were up for renewal after Debtors filed for bankruptcy, Debtors negotiated with Petitioner and other insurance companies. Pet. App. 11a. Petitioner's rates were the most favorable and the

amount of collateral was negotiated by petitioner and Debtors. Pet. App. 11a-12a.

2. On the deadline for filing administrative claims under Debtors' confirmed Plans, petitioner filed a request for priority treatment of an estimate of its maximum post-confirmation exposure under the Program (referred to by petitioner as the "Ultimate Loss Projection") pursuant to 11 U.S.C. §§ 503(b)(1)(A) and 507(a) (the "Priority Request"). Petitioner only filed this administrative expense claim to protect itself in the event Debtors' collateral failed. Pet. App. 48a.

The Priority Request initially sought almost $44 million, but petitioner was forced to reduce its demand significantly based on numerous errors. The Ultimate Loss Projection mistakenly included over $3 million for general liability and automobile insurance policies that petitioner was not obligated to pay.[3] App. 3a, ¶ 101-02. Petitioner also had not allowed credits for at least $9.5 million of deductible payments previously received by petitioner and third party administrators. App. 3a, ¶ 122. Further, the Ultimate Loss Projection failed to reflect over $23 million in cash collateral held by petitioner. App. 4a, ¶ 135. Notwithstanding that the original Priority Request was inflated by $35.5 million, leaving a

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[3] General liability and automobile policies do not have separate deductible agreements and only provide for billing after petitioner expends funds under the policies (e.g., legal fees, costs, injured party payments). App. 3a, ¶ 101-02. Petitioner is not obligated to pay amounts below the deductibles to claimants, so petitioner admitted it should not have sought a claim for such amounts. *Id.*

difference of $8.5 million, petitioner still seeks $14.6 million from Debtors' estates. Pet. 8; *see also* App. 3a-4a, ¶ 134.[4]

Even this amount is just petitioner's guess based on estimates at one point in time. The Ultimate Loss Projection will never show actual amounts due because it is a moving target that fluctuates up or down as the claims arising under one or more of the insurance policies are paid, settled or rejected. *See* App. 4a-5a, ¶ 173. "[T]he ultimate loss projections are actuarial analyses of the projected ultimate cost made on a regular periodic basis which employ information provided by the insured and updated loss information." *Id.*

The amount of petitioner's claim depends not only on estimates about future claims that may or may not arise, but also on assumptions about the value of certain collateral. As the District Court repeatedly observed, this case arises only because of the "failure" of certain collateral that petitioner agreed to accept. *See, e.g.*, Pet. App. 35a n.20, 48a. The District Court recognized that the amount of the Priority Request and the projected current deficiency on which it rests, "would have been substantially reduced" if the bonds secured by petitioner as collateral retained their value. Pet. App. 21a.

[4] Petitioner's Priority Request, if granted, would come at least in part from funds that are otherwise set aside to perform various reclamation obligations of Debtors. Pet. App. 24a. As the District Court noted, "the [priority] pool would fail in large measure to cover both Zurich's claim and the 'intended' reclamation costs." Pet. App. 24a. n.14.

Further, the District Court noted that, at least at the time of the District Court opinion, there remained a dispute about the value of the collateral. Pet. App. 50a-51a n.28.

Petitioner admits that it never called a default under the insurance contracts. App. 2a, ¶ 78. The record confirms that Debtors complied with their contractual obligations, paying substantially all amounts billed under the insurance policies during the administration period. *See, e.g.,* App. 1a-2a, ¶¶ 51, 69. Further, the Priority Request did not allege Debtors failed to comply with their contractual obligations under the Program.

3. Several parties in petitioner's position participated in the plan confirmation process and negotiated post-confirmation payments through incorporation of terms into the Plans.[5] Petitioner, however, affirmatively chose *not* to participate in the plan process. *See* Pet. App. 52a (the District Court indicated petitioner's failure to participate was potentially to its detriment); Pet. App. 68a (the Bankruptcy Court believed petitioner should have participated in the plan confirmation process).

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[5] *See, e.g.*, Reorganization Plan, as amended by the applicable Confirmation Order, §§ 2.1(d) ($1.8 million to second tier lienholders for legal fees/costs); 2.3 ($1 million to Deutsche Bank for possible suits on indemnified actions); 4.5(b) ($750,000 to third tier lienholders for legal fees/costs); and 6.5 ($40,000 to the third tier indenture trustee to offset costs to distribute recoveries to the claimants). (R. 2, Third Amended Joint Reorganization Plan, App. pp. 333, 334, 339 and 342; Confirmation Order, App. pp. 464-465 and 455-457.)

Therefore, the Plans did not provide an alternate mechanism to that specified in the insurance contracts for payment of the obligations arising in the future.

4. The Bankruptcy Court, the District Court, and Sixth Circuit have all rejected petitioner's efforts to use the judicial process to do something its insurance contracts prohibit — accelerating payment by granting administrative priority treatment to an estimate of the possible deductibles. The Bankruptcy Court concluded that the future deductible payments were "[e]xpenses incurred post-confirmation" and thus were not entitled to priority treatment. Pet. App. 64a. The court reasoned that only those payments due pursuant to the insurance contracts during the administration period were "actual, necessary costs and expenses of preserving the estate" under § 503(b)(1)(A). Pet App. 63a, 65a.

In a "comprehensive and well-reasoned opinion," the District Court affirmed the Bankruptcy Court's decision to deny petitioner's administrative expense claim. Pet App. 2a. Addressing only the "rare" issue before it, and emphasizing the lack of authority on point, the District Court examined both the limiting language of § 503(b)(1)(A), which classifies only those "actual, necessary costs and expenses of preserving the estate" as administrative claims, and the commonly applied "benefit to the estate" test. The District Court held: "[T]he Priority Request fails as a simple matter of statutory interpretation on both fronts: the claimed expenses are not 'actual' (i.e., not yet realized) and the payment thereof, when the obligations are realized, cannot act to preserve an estate that no longer exists." Pet. App. 27a.

The District Court understood that the expenses petitioner is attempting to classify as administrative expenses will only arise post-confirmation, if ever. Moreover, the District Court acknowledged that petitioner's purported future losses were not actual or necessary expenses because the costs did not exist when the Priority Request was made — and may never exist. The District Court recognized that petitioner would never know what the costs are, nor have the contractual right to invoice Debtors, until the claims are made by the covered workers and paid by petitioner. Pet. App. 27a. The District Court provided: "The moment Zurich is contractually permitted to seek reimbursement from Debtors for the advanced deductibles, the estate will have already dissolved and Debtors will cease to exist. Consequently, payment of the claimed expenses will in no way act to preserve an estate when there is no estate to preserve." Pet. App. 29a.

Once Debtors' bankruptcy estates ceased to exist, they could not incur further expenses. "In this unique context," the District Court observed, "courts, although few in number, have consistently held that expenses arising post-confirmation fail to satisfy the requirements for administrative priority under § 503 for the simple, yet inescapable reality that there is no estate to preserve or benefit." Pet. App. 40a. Paying obligations before their contractual due date makes little sense and provides no benefit to a bankruptcy estate. Thus, the District Court affirmed the Bankruptcy Court's decision to deny petitioner's Priority Request.

In a two-paragraph opinion that praised the District Court's thorough analysis, without adding

"anything of substance" to it, Pet. App. 2a, the Sixth Circuit affirmed the lower court's decision.

REASONS FOR DENYING THE PETITION

The case described in the petition bears little resemblance to the case actually litigated and decided by the courts below. While the petition describes a path-marking and conflict-creating decision of the Sixth Circuit, in reality, the Sixth Circuit issued just a two-paragraph summary affirmance of a decision of the District Court. Rather than wading into any circuit splits, the District Court repeatedly observed it was deciding a very narrow issue that both parties conceded was one of first impression. The District Court focused on the unusual nature of the contractually-agreed deductible reimbursement obligation, and addressed only the distinct circumstances that created the narrow issue presented by this case: whether the reimbursement obligation of an insured-debtor that does not arise by the negotiated terms of the contract until after the covered workers make, and the insurer pays, the allowed claims in the future is entitled to administrative priority treatment. The District Court's careful resolution of this narrow issue implicates no circuit split and hardly threatens the ability of entities in bankruptcy to obtain insurance.

Petitioner does not even try to suggest that any other circuit has addressed the specific issue here, let alone come to a different conclusion. Once it is clear that the District Court addressed only a narrow and unique issue, the cases petitioner cites easily distinguish themselves. For example, cases

involving the treatment of CERCLA liability or post-petition, but pre-confirmation, lease defaults shed little light on, and certainly do not control, the proper treatment of a contractual obligation to reimburse the deductible portion of claim payments. This is particularly true where the claims have been neither made nor paid, and no contractual repayment obligation exists at the time of the request for priority treatment. Likewise, the District Court's handling of this unusual contractual arrangement does not implicate any well-entrenched three-way split concerning broader issues of when claims arise. In fact, petitioner's argument acknowledges that the only Sixth Circuit case cited by the District Court actually rejects the analysis of the Third Circuit case petitioner finds offensive and identifies as the root of the circuit split.

The District Court's decision also does not threaten the broader policies of bankruptcy law or the ability of entities in bankruptcy to obtain insurance. The petition ignores the essential fact that petitioner attempted to protect against loss by securing collateral for the deductible obligations. Petitioner also glosses over the District Court's repeated observations that this case arises only because of the failure of some of that collateral.

These two facts are critical and contradict petitioner's assertion that existing law gave it a clear right to treat the unusual contract reimbursement obligations as administrative expenses. If the law were as clear as petitioner now paints it, petitioner would have little need for collateral. The ability of insurers to insist on such collateral likewise demonstrates that the decision below does not signal

the end of deductible policies for entities in bankruptcy. The decision simply means that insurers must abide by contract terms and ensure that the collateral they demand is, in fact, valuable. Finally, the fact that this case arises only because of the failure of the collateral underscores the unique nature of this controversy and explains the absence of other precedential opinions addressing the proper treatment of deductible obligations.

I. THE DISTRICT COURT'S DECISION DOES NOT CREATE A CIRCUIT SPLIT ON THE TREATMENT OF POST-CONFIRMATION CONTRACT OBLIGATIONS OR CREATE TENSION WITH *READING*.

In the first of several attempts by petitioner to transform the District Court's decision into a conflict-creating precedent, petitioner claims that the opinion conflicts with decisions from the First, Second and Fourth Circuits over the relation back of obligations arising from post-petition contracts. *See Juniper Dev. Group v. Kahn (In re Hemingway Transp., Inc.)*, 993 F.2d 915 (1st Cir. 1993); *Devan v. Simon DeBartolo Group, L.P. (In re Merry-Go-Round Enters., Inc.)*, 180 F.3d 149 (4th Cir. 1999); *Nostas Assocs. v. Costich (In re Klein Sleep Prods., Inc.)*, 78 F.3d 18 (2d Cir. 1996). Petitioner also asserts that the Sixth Circuit's summary affirmance is in "tension" with this Court's decision in *Reading Co. v. Brown*, 391 U.S. 471 (1968).

At the outset, it bears emphasis that the District Court repeatedly emphasized the unique factual setting of this case, the narrowness of the issue decided and the complete absence of precedent. For

example, the District Court referred to the facts and issue variously as "very narrow," at Pet. App. 24a, involving "unique circumstances," at 33a, a "special case," at 33a, a "rare issue," at 34a, a "unique context," at 40a, and "narrow circumstances," at 48a. The District Court then, in a section entitled "Case of First Impression," noted that "the parties readily acknowledged during oral argument, ... an unfortunate lack of precedent capable of shedding light on the rare issue at hand," at 40a. The District Court went on to lament "the void of controlling authority," at 35a, and the "lack of precedential guidance," at 38a. Petitioner nonetheless attempts to create a circuit split out of this raw material.

None of the decisions petitioner cites deals with the type of unique contractual obligations and terms at issue here. Two of these cases, *Merry-Go-Round* and *Klein Sleep*, consider assumptions of leases that expressly provide for accelerated rental payments due immediately upon early termination. The third, *Hemingway*, considers post-confirmation obligations in connection with environmental provisions under CERCLA. Whatever the proper treatment of such obligations, these cases say nothing about the treatment of the unusual reimbursement obligations in the insurance contract here, which will not even arise until claims are made and paid long after the end of the administration period.

Similarly, *Reading*, which holds that a tort claim arising during the administration period is an actual, necessary expense of preserving the estate, has nothing to do with the unique type of contractual obligations at issue in this case. Neither a purported circuit split nor tension with *Reading* was created by

the Sixth Circuit's short, summary decision adopting the reasoning of the District Court's thorough analysis of the "very narrow" issue presented here.

1.a. In *Hemingway*, Juniper Development Group ("Juniper") sought indemnification for its current and future response costs under CERCLA pursuant to a post-petition asset purchase agreement. The *Hemingway* court's decision mined the "increasingly crowded 'intersection' between the discordant legislative approaches embodied in CERCLA and the bankruptcy code." 993 F.2d at 921. Fortunately, such an endeavor is neither necessary nor relevant here. Even the most cursory review of the *Hemingway* opinion demonstrates that the complex issues addressed there look nothing like the issue here. This case has nothing to do with CERCLA liability, which itself involves complex questions related to apportioning cleanup costs, nor does this case implicate § 502(e)(1)(B) of the Bankruptcy Code, which disallows the claims of a codebtor that is jointly liable with the debtor on a creditor's claim. Contrary to petitioner's claim in a footnote (Pet. 14 n.5), the court in *Hemingway* focused most of its analysis on the impact of § 502(e)(1) and the discord between the legislative goals of bankruptcy and environmental laws. *See Hemingway*, 993 F.2d at 921.

The only possible relevance of *Hemingway* is the First Circuit's agreement with the District Court here that "contingent" costs are not eligible for administrative expense priority:

> [W]e agree that . . . priority is unavailing to Juniper insofar as its

> right to contribution for future response costs remains "contingent" at the time the bankruptcy court considers Juniper's claim for allowance against the debtor estate. Only "actual" administrative expenses, not contingent expenses, are entitled to priority payment under Bankruptcy Code § 503(b)(1)(A).

993 F.2d at 930. Just like petitioner's Priority Request, Juniper's right to a future contribution claim would be disallowed unless it became "fixed and actual." *Id.*

The vastly different facts and contexts do not allow an easy comparison of *Hemingway* to the current proceeding. A careful reading of *Hemingway* reveals that it sheds no light on the unusual contractual obligations at issue here.[6] The District Court here recognized the grant of administrative priority treatment would improperly accelerate a contractual payment obligation and effectively rewrite the underlying insurance contracts; the claim dispute in *Hemingway* did neither. The *Hemingway* decision is simply not in conflict with the decision here.

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[6] Also, *Hemingway* was a case converted to Chapter 7 and did not involve application of a plan of reorganization. Here, petitioner is constrained by the final terms of the confirmed Plans that do not provide a means of payment.

b. The other two cases petitioner identifies as part of the alleged circuit split, *Merry-Go-Round* and *Klein Sleep*, are inapposite. *Merry-Go-Round* involved a post-conversion breach of an assumed lease by a Chapter 7 trustee. In *Klein Sleep*, the Chapter 11 debtor failed to confirm a plan and then breached an assumed lease. Because the lease defaults occurred during the administration of the bankruptcy cases, the non-debtor party was allowed to enforce its contract remedies. One of the remedies under the leases was acceleration of amounts due. *See Merry-Go-Round*, 180 F.3d at 152; *Klein Sleep*, 78 F.3d at 20-21.

The holdings in *Klein Sleep* and *Merry-Go-Round* merely reflect a consensus among courts regarding the treatment of a very specialized and easily identifiable type of claim: a damage claim for future rent arising from an assumed lease that was breached during the administration of the debtor's estate.[7] In these cases, the courts gave effect to existing contractual terms that permitted immediate acceleration of rental payments due upon breach of a

[7] Recent Congressional legislation — the addition of § 503(b)(7) to the Bankruptcy Code — confirms this consensus, but also reflects the concerns that are raised when significant future obligations are contractually accelerated and given priority treatment. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1103. Section 503(b)(7) recognizes that such future rent claims are administrative expenses, but explicitly limits the priority amount of these claims to two years post-rejection rent or actual turnover of the premises. 11 U.S.C. § 503(b)(7).

lease assumed during the administration of the bankruptcy estate. By recognizing that these contract damages were entitled to administrative expense priority, the courts did little more than enforce contractual terms freely bargained for between the landlord and the debtor/lessee, in contemplation of the lessee's default.

The reasoning of *Merry-Go-Round* and *Klein Sleep* does not apply to these facts. Here, Debtors successfully confirmed Chapter 11 plans and emerged from bankruptcy without any breach of the underlying insurance policies. Further, the existence of a default is not asserted in the Priority Request, nor is it relevant to the calculation of the Ultimate Loss Projection.

Petitioner's arguments also make no practical sense. If petitioner's position succeeds, any party that has a post-petition contract may seek actuarially accelerated "damages" solely because the contract was assumed or executed by a debtor in possession during the administration of the bankruptcy case. Far from enforcing the contract terms as in *Merry-Go-Round* and *Klein Sleep*, allowing petitioner to require immediate payment in the form of an administrative expense claim for possible future insurance obligations would accelerate the mutually agreed upon payment dates and breach the insurance contracts.

2. Petitioner also suggests that the decision below is in tension with *Reading Co. v. Brown*, 391 U.S. 471 (1968). In *Reading*, this Court determined that an accrued tort claim — fire-loss damages arising from the receiver's negligent use and control

of the debtor's building post-petition — was an actual and necessary cost of operating the debtor's business, even though paying the claim provided no benefit to the debtor's bankruptcy estate. The Court reasoned that "'actual and necessary costs' should include costs ordinarily incident to operation of a business, and not be limited to costs without which rehabilitation would be impossible." *Reading*, 391 U.S. at 483.

Nothing in *Reading*'s treatment of the accrual of tort claims remotely implicates the very different circumstances at issue here. There, the particular loss, the claims arising out of that loss, and the obligations incurred by the debtor all arose during the administration period of the estate. *Id.* at 473-74. Here, in the context of a contractual obligation, the opposite is true. Debtors are under no legal obligation to pay any deductible until the claim is made long after the end of the administration period.

The District Court recognized that *Reading* dealt with analytically distinct issues. The District Court characterized the *Reading* line of cases as a "refined benefit to the estate approach, which was developed largely in response to the common problem of characterizing damages from legal judgments . . . ." Pet. App. 30a (footnote omitted). The District Court found that approach of limited utility because the underlying dispute here involves interpretation of contracts, and not legal judgments. Pet. App. 31a. The *Reading* test is appropriate for a select group of difficult to classify claims: torts, penalties for injunction violations, penalties related to environmental remediation costs and fines for violating a federal or state statute. *See Caradon*

Doors and Windows, Inc. v. Eagle-Picher Indus., Inc. (In re Eagle-Picher Indus., Inc.), 447 F.3d 461, 464 (6th Cir. 1995) (providing a discussion of the types of claims that are supported by a *Reading* analysis).

The nature of the Priority Request here is starkly different. The Priority Request is not based on a tort, breach of contract or other wrongful action by Debtors. To the contrary, petitioner has never alleged wrongful conduct by Debtors.[8] Instead, this case turns on the proper treatment of unusual contractual obligations that the insurer required and the insureds accepted. Moreover, it is the non-debtor party, petitioner, that is attempting to avoid the explicit terms of the underlying agreements. There is simply no tension between *Reading* and the decision below.

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[8] The Court in *Reading* did acknowledge that ordinary insurance premiums are entitled to administrative priority treatment. "It is of course obvious that proper insurance premiums must be given priority, else insurance could not be obtained . . . ." *Reading*, 391 U.S. at 483. Here there is no dispute regarding premium expenses incurred during the administration period. Only the unusual future reimbursement obligations are in dispute. That reality underscores the lack of tension between the decision below and *Reading*, and demonstrates that the decision below addresses unique and unusual obligations far outside the contemplation of the *Reading* Court.

II. THE DECISION BELOW ADDRESSES AN UNUSUAL CONTRACT REIMBURSEMENT PROVISION AND DOES NOT IMPLICATE ANY CIRCUIT SPLIT CONCERNING WHEN A CLAIM ARISES.

Overlooking the parties' ready acknowledgment that there was "an unfortunate lack of precedent capable of shedding light on the rare issue at hand," Pet. App. 34a, and the District Court's repeated observation that this case presented a unique and narrow issue, petitioner now argues that the decision below weighs in on a long-standing three-way split of authority involving how courts determine whether a party has a claim under § 101(5) of the Bankruptcy Code. *See, e.g.*, *Epstein v. Official Committee of Unsecured Creditors of the Estate of Piper Aircraft Corp.*, 58 F.3d 1573, 1577 (11th Cir. 1995) ("We . . . adopt what we call the 'Piper test' in determining *the scope of the term claim under § 101(5)* . . . .") (emphasis added); *Grady v. A.H. Robins Co.*, 839 F.2d 198, 199 (4th Cir. 1988) ("While the parties agree that the term claim is broadly defined under the Bankruptcy Code, they disagree over whether [plaintiff's] suit falls within that definition.").

This case only addresses the distinct issue of whether an administrative expense is allowed and has nothing whatsoever to do with whether petitioner has a claim within the meaning of § 101(5). The District Court acknowledged from the outset that the issue presented here was not "whether [the prospective deductible obligations] are in fact 'legal' obligations," but whether those obligations "should receive administrative expense

treatment . . . above that afforded to most creditors." Pet. App. 23a-24a. There is no need to decide whether the prospective deductible obligations are *claims* within the meaning of § 101(5)(a); the disagreement only concerns whether these estimated future payments are entitled to *administrative priority treatment.*[9]

Petitioner attempts to conflate the timing issue in determining when a claim arises and the timing issue concerning administrative expenses accruing after the bankruptcy estates terminate. But the relevant statutory provisions involve different requirements and distinct bankruptcy policies. Conflating the issues may produce some confusion, but it does not create an actual split of authority.

1. Petitioner's argument fails to account for the fact that very different guiding principles govern the respective issues concerning: (1) when claims arise for the purpose of determining what is and is not a bankruptcy claim, generally, and (2) when claims

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[9] The Brief submitted in support of petitioner on behalf of the *Amici Curiae* States, appears to acknowledge as much. *Amici Curiae* States' Brief 13 n.6. *Amici* then assert that even if the decision below addresses only the accrual of an administrative expenses, it nevertheless merits this Court's review. *Id.* at 16-20. *Amici*'s sky-is-falling argument with respect to future calamities that may result from the application of this exceedingly narrow issue is out-of-step with the reality that this is a case of first impression for *any* court. Accordingly, the District Court's decision should only affect the very narrow and heretofore undiscovered class of cases involving specific payment terms in insurance contracts. Any possible impact on those cases is avoided if insurers secure adequate collateral and stay involved in any bankruptcy proceeding.

arise for the purpose of determining what is and is not an "administrative expense."

a. As *Amici Curiae* States demonstrate, the purported circuit split described in the petition has emerged as courts have grappled with the purposefully broad language of § 101(5)'s definition of a claim, which extends to contingent and potentially unrealized claims of liability. *Amici Curiae* States' Brief 10-11. Section 101(5) defines a "claim" under the Bankruptcy Code to mean a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5). Courts have consistently recognized that both the broad text of the statute and also the legislative history indicate that "Congress intended the term 'claim' to be given broad interpretation so that 'all legal obligations of the debtor, no matter how remote or contingent will be able to be dealt with in the bankruptcy case.'" *Lemelle v. Universal Manufacturing Corp.*, 18 F.3d 1268, 1275 (5th Cir. 1994) (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess. 309 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5963, 6266); *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997, 1003 (2d Cir. 1991) ("Congress unquestionably expected this definition to have wide scope.").

The broad language employed by the statute is not unlimited. As the Second Circuit explained when it rejected the broad conduct test, "[d]efining claims to include any ultimate right to payment arising from prepetition conduct by the debtor comports with the theoretical model of assuring that

all assets of the debtor are available to those seeking recovery for prepetition conduct. But such an interpretation of 'claim' yields questionable results." *Chateaugay*, 944 F.2d at 1003. Accordingly, the circuit split invoked by petitioner here reflects the courts' attempts to avoid the "questionable results" that might otherwise derive from the broad and seemingly unlimited definition of a "claim." That difficult task has nothing to do with issues here, which are answered simply by reviewing the specific terms of the insurance contracts.

b. The broad definition of a "claim" within the meaning of the Bankruptcy Code contrasts starkly with the narrow definition of administrative expenses entitled to priority under § 503(b)(1)(A). Administrative expenses include only "the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1)(A). Whereas the definition of a "claim" is unquestionably broad, the definition of an administrative expense is unquestionably narrow, as the cases that petitioner cites involving administrative expense claims readily acknowledge. *See Merry-Go-Round*, 180 F.3d at 157 ("Since there is a general presumption in bankruptcy cases that all of a debtor's limited resources will be equally distributed among creditors, § 503 [providing for priority claims], must be narrowly construed."); *Klein Sleep*, 78 F.3d at 23 (affirming "stated policy that priorities in bankruptcy should be narrowly construed and sparingly granted"); *see also Otte v. United States*, 419 U.S. 43, 53 (1974) (holding that there is an overriding concern to keep administrative expenses at a minimum).

The text of § 503(b)(1)(A), in contrast to the text of § 101(5), does not recognize "contingent" administrative expenses; administrative priority claims must be "actual" and "necessary." *Accord Hemingway*, 993 F.2d at 930 ("Only 'actual' administrative expenses, not contingent expenses, are entitled to priority payment under Bankruptcy Code § 503(b)(1)(A)."). Accordingly, the decisions involving the definition of a claim under § 101(5) are not only inapposite, they reflect bankruptcy policies that produce conflicting presumptions. The interest that supports a broad encompassing conception of prepetition claims cannot be conflated with the impulse toward narrowly construing post-petition administrative expenses.

2. The distinct question of when a claim arises under § 101(5) has nothing to do with the narrow, rare and unique issue the District Court actually resolved. This is underscored by the fact that the only case that even implicates this split that was actually relied upon by the District Court was *Pension Benefit Guaranty Corp. v. Sunarhauserman, Inc. (In re Sunarhauserman, Inc.)*, 126 F.3d 811 (6th Cir. 1997). *Sunarhauserman* is a Sixth Circuit decision that, as acknowledged by petitioner, falls on the side of this presumed split that is more favorable to petitioner's position. Pet. App. 30a; Pet. 25 n.9 (acknowledging that *Sunarhauserman* stated that the "proper standard for determining [a] claim's administrative priority looks to when the acts giving rise to a liability took place, not when they accrued"). Thus, the idea that the decision below is a product of a Sixth Circuit decision that joins the Third Circuit on the minority

side of a three-way split does not square with the actual decision of the District Court.

More fundamentally, the issue that divided the circuits has nothing to do with the issue actually resolved by the District Court. *Sunarhauserman* is the only case among those identified by petitioner in this purported three-way split that even addresses accrual of claims with respect to determining an administrative expense claim as opposed to determining whether a claim accrued pre- or post-petition. The cases petitioner cites are for the purposes of determining (1) whether the claim was discharged in bankruptcy, *e.g.*, *Watson v. Parker (In re Parker)*, 313 F.3d 1267 (10th Cir. 2002); *CPT Holdings, Inc. v. Industrial & Allied Employees Union Pension Plan*, 162 F.3d 405 (6th Cir. 1998); *Butler v. Nationsbank, N.A.*, 58 F.3d 1022 (4th Cir. 1995); *Lemelle v. Universal Manufacturing Corp.*, 18 F.3d 1268 (5th Cir. 1994); *In re Chateaugay*, 944 F.2d 997 (2d Cir. 1991); or (2) whether the claim was subject to the automatic stay provision of § 362(a)(1), *Grady v. A.H. Robins Company, Inc.*, 839 F.2d 198 (4th Cir. 1988).

One case was careful to note that decisions on the threshold issue of how to define a claim do not impact or resolve issues related to the status of an administrative claim. *See Grady*, 839 F.2d at 199 (adopting the conduct test applied by the district court and emphasizing the narrowness of the district court's holding and noting that it "did not decide whether or not . . . claim would constitute an administrative expense"). Another court separately addressed and considered the status of an administrative expense claim that related solely to

actual, fixed costs, after resolving issues related to contingent, unrealized costs. *See Chateaugay*, 944 F.2d at 1009-10 (authorizing recovery of actual clean-up costs under CERCLA that accrued and were expended during the administration period).

Moreover, these cases apply the generalized discussion of when a claim accrues for purposes of the definition of a claim in § 101(5) to either tort or regulatory contexts — and not under circumstances where the parties have defined their contractual responsibilities in the form of the distinct reimbursement obligations at issue here. *See, e.g., Watson v. Parker (In re Parker)*, 313 F.3d 1267 (10th Cir. 2002) (legal malpractice); *CPT Holdings, Inc. v. Industrial & Allied Employees Union Pension Plan*, 162 F.3d 405 (6th Cir. 1998) (statutory withdrawal liability); *In re Sunarhauserman, Inc.*, 126 F.3d 811 (6th Cir. 1997) (unpaid post-petition minimum funding contributions); *Butler v. Nationsbank, N.A.*, 58 F.3d 1022 (4th Cir. 1995) (fraudulent conveyance); *Lemelle v. Universal Manufacturing Corp.*, 18 F.3d 1268 (5th Cir. 1994) (wrongful death); *In re Chateaugay*, 944 F.2d 997 (2d Cir. 1991) (statutory environmental claims); *Grady v. A.H. Robins Company, Inc.*, 839 F.2d 198 (4th Cir. 1988) (mass tort litigation); *Kilbarr Corp. v. Gen. Servs. Admin. (In re Remington Rand Corp.)*, 836 F.2d 825 (3d Cir. 1988) (federal Contract Claims Act); *Jones v. Chemetron Corp.*, 212 F.3d 199 (3d Cir. 2000) (mass tort litigation); *In re Piper Aircraft Corp.*, 162 B.R. 619 (Bankr. S.D. Fla. 1994) (personal injury/wrongful death); *Avellino & Bienes v. M. Frenville Co., Inc. (In re Frenville Co., Inc.)*, 744 F.2d

332 (3d Cir. 1984) (common law indemnification and contribution claims for tort liability).

Although petitioner and *amici* seize on this purportedly long-standing split among the circuit courts in order to elevate the importance of the decision below, this case does not implicate the question that divides the circuits. This case only addresses a unique, contract-specific issue that the District Court and parties below correctly treated as one of first impression.

III. NO COMPELLING POLICY ARGUMENTS UNDERLIE THIS CONTRACT DISPUTE.

Petitioner's policy arguments are an attempt to deflect the analysis from the specific terms of the underlying contracts and petitioner's own mistakes. *See* Pet. 30-34. As the District Court correctly recognized, this matter involves case specific contract terms and a mistake by petitioner involving collateral, not some broader threat to the availability of insurance for entities in bankruptcy. Bankruptcy laws are structured to induce creditors to work with bankrupt entities, but they also seek fair and consistent treatment of similarly situated creditors. *Compare Reading*, 391 U.S. at 477 (An "important" statutory objective of chapter 11 is "fairness to all persons having claims against an insolvent.") *with Otte*, 419 U.S. at 53 ("There is, of course, an overriding concern in the Act with keeping fees and administrative expenses at a minimum so as to preserve as much of the estate as possible for the creditors."). These goals sometimes clash, but *not* in this case.

Petitioner attempted to assert priority status for the future contract payments to overcome the impact of the anticipated failure of some of its underlying collateral.[10] As indicated in the Statement, Debtors provided almost $14 million in surety bonds as part of a collateral pool that also included substantial amounts of cash. The sum of the bonds approximately equals the total amount of the Priority Request. Although petitioner has made a claim under these bonds, collection of a portion of the proceeds is in dispute. Pet. App. 21a, n. 13. Also, the issuer of the surety bonds is in receivership in the state of New York. *Id.*

The District Court correctly recognized that the failure of this collateral is the raison d'être of this dispute. *See* Pet. App. 35a, n. 20. The very fact that petitioner demanded extensive collateral approximately equal to its exposure undermines petitioner's assertion that this type of future contract obligation is routinely given administrative priority treatment and the suggestion that the decision below threatens the availability of deductible policies for entities in bankruptcy. *Id.* It was clear to the District Court that this controversy is the result of "failed collateral, which Zurich incidentally required to offset some of the risk attendant to deductible policies, especially those entered into with companies in bankruptcy, despite an alleged custom in bankruptcy that priority status

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[10] Petitioner has admitted that the claim was filed as a protective measure in the event of the ultimate failure of any of the collateral. App. 2a-3a, ¶ 94.

is routinely awarded for insurers in Zurich's shoes." *Id.*

The District Court also recognized that the case-specific failure of collateral undermined any argument that this decision had broad repercussions. Whereas "[t]he value that insurance coverage provides to debtors-in-possession during bankruptcy cannot be overstated[,] . . . the precedential repercussions felt by denying Zurich's claim under these narrow circumstances will not produce the dire picture that Zurich now paints." Pet. App. 48a. Petitioner is "an incredibly sophisticated, for-profit insurance corporation that was fully aware of the risks associated with insuring a financially-troubled business" such as the operations of Debtors. Pet. App. 50a. Other insurance companies bargained with Debtors to provide insurance, and petitioner earned the business by underbidding its competition. Pet. App. 11a-12a. "Proverbially speaking, Zurich made its bed and the other parties in interest — including [respondent] and the public by way of reclamation — should not be forced to sleep in it." Pet. App. 48a. The courts below appropriately balanced the competing policy and business interests to arrive at an equitable resolution of an unfortunate — and rare — outcome resulting from "arm's length and contentiously negotiated" insurance contracts. Pet. App. 51a. This case does not signal the end of the

availability of insurance — including deductible policies — for other financially troubled insureds.[11]

IV. THE UNIQUE ISSUE BEFORE THE LOWER COURTS WAS CORRECTLY DECIDED.

The District Court's analysis of the "very narrow" and "unique" issue presented here not only fails to create a circuit split or threaten any public policy calamity, *it was also correct.* Petitioner's Priority Request for their unusual contractual obligations that will not even arise until future claims are made

[11] The *Amici Curiae* States indicate they "are concerned with enforcing state laws that assure that injured employees who are covered by their employer's workers' compensation insurance . . . actually receive their workers compensation benefits," and are also concerned about whether employees of companies that are self-insured will retain their coverage if the companies enter bankruptcy. *Amici Curiae* States' Brief 1, 2. Those concerns, while obviously legitimate, have nothing to do with the decision below. Debtors' employees here will receive their workers' compensation payments. In fact, the reason petitioner seeks priority treatment is because petitioner is statutorily and contractually obligated to make payments to Debtors' employees whether or not future deductibles are reimbursed. The problem of coverage for self-insured employers is a real one, but not one that has anything to do with the treatment of the specific contractual reimbursement provision at issue here. Moreover, for the reasons addressed above, the District Court's decision does not threaten the availability of insurance coverage — with or without deductible reimbursement provisions — to entities near or in bankruptcy, it only requires insurers to scrutinize the value of collateral. Simply put, petitioner's real problems, failure of a portion of the collateral and inattention to the bankruptcy plan process, will not impact employees of Chrysler, GM or any insured, self-insured or illegally uninsured company.

and paid may only receive priority treatment if petitioner bears its burden of showing that they are "actual" and "necessary" to preserve Debtors' estates. 11 U.S.C. § 503(b)(1)(A). That is precisely what petitioner failed to prove.

1. The District Court held: "It is in this regard that the Priority Request fails as a simple matter of statutory interpretation on both fronts: the claimed expenses are not 'actual' (*i.e.*, not yet realized) and the payment thereof, when the obligations are realized, cannot act to preserve an estate that no longer exists." Pet. App. 27a. The lower courts understood that the obligations that petitioner is attempting to classify as administrative expenses will only arise post-confirmation, if ever.

a. Estimated costs based on an Ultimate Loss Projection are not actual or necessary expenses because the costs did not exist when the Priority Request was made — and may never exist. The District Court recognized petitioner would never know what the costs are, nor have the contractual right to invoice Debtors, until the charges are incurred and paid by petitioner. Pet. App. 27a. "The bottom line remains that Zurich is not contractually obligated to pay any of the deductible obligations in question until claims are filed, which will necessarily occur post-confirmation." Pet. App. 29a. When petitioner is finally permitted under the insurance contracts "to seek reimbursement from Debtors for the advanced deductibles, the estate will have already dissolved and Debtors will cease to exist." *Id.* Thus, "payment of the claimed expenses will in

no way act to preserve an estate when there is no estate to preserve."[12] *Id.*

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[12] *Amicus* National Union, but not petitioner (despite working long and hard to find a circuit split lurking in a district court decision addressing an issue of first impression), attacks the District Court's determination that the administration of the estates terminated upon confirmation of Debtors' Plans. According to National Union, this view conflicts with holdings in the Second and Eighth Circuits and the Bankruptcy Code. National Union Brief 18-21. There is no conflict.

Section 1141 of the Code addresses the effects of plan confirmation on a debtor's bankruptcy estate and the estate's assets. *See* 11 U.S.C. § 1141. The general rule under § 1141 of the Bankruptcy Code is that the bankruptcy estate is no longer required upon the confirmation of the debtor's chapter 11 plan. *Venn v. Kinjite Motors, Inc. (In re WMR Enters., Inc.)*, 163 B.R. 887, 889 (Bankr. N.D. Fla. 1994). The bankruptcy court and plan proponents may modify the general rule by including provisions in the plan or confirmation order that specifically address what happens to the estate or unadministered estate assets. *In re Chisolm*, 156 B.R. 336 (Bankr. M.D. Fla. 1993), *aff'd without rehearing* 157 B.R. 710; *see also In re Cumberland Farms, Inc.*, 162 B.R. 62 (Bankr. D. Mass. 1993). The Debtors' Plans did not alter the default rule of § 1141, so Debtors' bankruptcy estates were no longer required upon confirmation and sale of the Debtors' assets. In fact, the provisions of the Confirmation Orders contemplated termination of Debtors' estates. *See* Reorganization Order L. 2. (z) and Liquidation Order L. 2. (aa) (on the Effective Dates of the Plans, "Debtors shall be deemed dissolved").

National Union points to § 554(d) of the Bankruptcy Code to support its argument that the estate survives plan confirmation. Section 554(d), however, deals with abandonment of property of the estate, and here there is no abandoned or unadministered assets, so § 554(d) is inapposite.

The cases National Union cites deal with special situations that are not remotely implicated here and do not detract from

Once Debtors' bankruptcy estates ceased to exist, they could not incur further expenses. "In this unique context, courts, although few in number, have consistently held that expenses arising post-confirmation fail to satisfy the requirements for administrative priority under § 503 for the simple, yet inescapable reality that there is no estate to preserve or benefit." Pet. App. 40a.

This is not just a matter of known expenses that are not yet payable. Here, the obligation to reimburse the deductibles will not even arise by contract until covered claims are made and paid, long after the administration period has ended. Claims incurred post-confirmation are simply ordinary creditor claims against the post-confirmation debtor. *See In re Frank Meador Buick, Inc.*, 65 B.R. 200, 203 (W.D. Va. 1986). Thus, the estimated future obligations described in the Priority Request are not actual or necessary under Section 503(b)(1)(A).

Petitioner concedes, as it must, that it can only estimate the deductibles it might pay because the actual obligation to reimburse deductibles will not arise until the future. Still, petitioner insists the insured must advance the money to cover the

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the general rule. *Chartschlaa v. Nationwide Mut. Ins. Co.*, 538 F3d 116 (2d Cir. 2008) (involving a chapter 7 debtor who concealed various prepetition interests and claims in his insurance business by failing to schedule or otherwise disclose them to the trustee); *Security Bank v. Neiman*, 1 F.3d 687 (8th Cir. 1993) (involving a chapter 7 case converted from chapter 13 and raising distinct issues related to preconversion administrative expense claims).

deductibles now. This directly conflicts with the terms of the insurance contracts and is nothing more than a breach of those agreements.

b. Courts should not allow a party to ignore the negotiated obligations in the insurance policies. The concept that a debtor must comply with the terms of its contracts is a fundamental principle of bankruptcy law that is without dispute. *See, e.g., Stewart Title Guaranty Company v. Old Republic National Title Insurance Company,* 83 F.3d 735, 741 (5th Cir. 1996) ("It is well established that as a general proposition an executory contract must be assumed or rejected in its entirety."); *City of Covington v. Covington Landing Ltd. P'ship (In re Covington Landing Ltd. P'ship),* 71 F.3d 1221, 1226 (6th Cir. 1995) (a debtor must assume all benefits and burdens of a contract); *In re Nitec Paper Corp.*, 43 B.R. 492, 498 (S.D. N.Y. 1984) ("A contract assumed in bankruptcy is accompanied by all its provisions, and conditions. It may not be assumed in part and rejected in part."); *In re Camptown, Ltd.*, 96 B.R. 352, 355 (Bankr. M.D. Fla. 1989) ("It is well established that as a general proposition an executory contract must be assumed or rejected in its entirety.").

The corollary, that the non-debtor party should also comply with its contractual obligations, is likewise unassailable. Moreover, enforcement of a contract between a debtor and non-debtor is simply a matter of state contract law. *See Erie R.R. v. Tompkins*, 304 U.S. 64, 78 (1938) ("Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state."); *see also American Inv. Fin. v.*

United States, 476 F.3d 810, 813 (10th Cir. 2006) (citing *Aquilino v. United States*, 363 U.S. 509, 512-13 (1960)) ("Federal law creates no property right, but does attach federally defined consequences to rights created under state law."); *Perez v. Aetna Life Ins. Co.*, 150 F.3d 550, 556 (6th Cir. 1998) ("In developing federal common law rules of contract interpretation, we take direction from both state law and general contract law principles."). Petitioner has failed to present any legal authority that would allow a contract party — debtor or non-debtor — to judicially amend a contract or actuarially accelerate contract payments when the agreement prohibits this result.

2. The District Court's opinion also represents a straightforward and correct application of the benefit to the estate test. Many circuits apply the same benefit to the estate test without conflict, but no court of appeals has addressed this kind of contractual reimbursement obligation and afforded it administrative priority. If another court of appeals ever addresses a case of failed collateral, the result will depend on the terms of the insurance policies, the collateral, the diligence of the carrier and many other fact specific issues. Under these facts, including the specific terms of the arms-length insurance contracts, the decision should always be the same because payments due by contract at some point in the future will not likely benefit an existing bankruptcy estate. But in all events, no such case has arisen.

Petitioner and its *amici* seek to lump the entire insurance program together and argue that the insurance represents a "benefit" to the estate. Pet.

12. But that ignores the character of the reimbursement obligation. Debtors paid all that they were obligated to pay by contract for the benefit of the insurance coverage, including premiums and deductibles, during the administration period. *See* Statement. The only question here is the treatment of aspects of the overall insurance program that may only be performed post-confirmation.

The District Court characterized petitioner's argument as follows: "Zurich asserts that the accrual of the claims should essentially relate back to the underlying insurance coverage as part and parcel of the relevant insurance policies, which include *the premium obligations that were assigned administrative priority and satisfied accordingly.*" Pet. App. 28a (emphasis added); *see also* Pet. 12-13. But petitioner's argument mischaracterizes the benefit question these facts present. The "benefit" issue addressed is whether Debtors' estates benefit from the upfront payment of obligations that only arise by contract outside the administration period. They do not. A bankruptcy estate does not benefit from paying obligations it has no contractual duty to pay and which have, in fact, not yet arisen (and may never arise). Making such payments out of time makes no economic, legal or practical sense.

Further, in addition to insurance coverage under the Program, petitioner agreed to handle various matters of administration and claims management that occur after termination of the insurance coverage. More importantly, petitioner contractually obligated itself to *advance* money for deductibles *before* Debtors have any obligation to pay. Until petitioner fulfills its bargained-for, administrative

obligations and advances the deductibles, the full benefit of the deductible insurance contracts is not received. Allowing the Priority Request, thus requiring payment from Debtors before Petitioner makes any disbursements, would completely reverse this contractual arrangement. These obligations are not performed by petitioner, nor are the corresponding benefits received by Debtors, until *after* the end of the administration period. "Even assuming arguendo that the expenses arose (or *will arise* in Zurich's case) from a transaction with the bankruptcy estate," the District Court reasoned, "accelerated reimbursement via administrative priority status will not act to provide a direct and substantial benefit to the estate where the claimed expenses will not become legal obligations until unknown points in the future, if ever." Pet. App. 32a (emphasis in original).

As is plain from the text of § 503, administrative expenses do not include "contingent" or "unmatured" claims. The decisions below correctly held that the unique type of obligations at issue here were not "actual" expenses that were "necessary" to preserve the bankruptcy estate.

CONCLUSION

For the foregoing reasons, respondent respectfully requests that the Court deny the Petition for a Writ of Certiorari.

Respectfully submitted,

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May 29, 2009

APPENDIX

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
ASHLAND DISTRICT

IN RE:	)	CHAPTER 11
	)	
HNRC DISSOLUTION	)	CASE NO. 02-14261
CO. F/K/A HORIZON	)	
NATURAL RESOURCES	)	JOINTLY
COMPANY, ET AL.,	)	ADMINISTERED
DEBTORS.	)	
	)	JUDGE WILLIAM
	)	S. HOWARD

RELEVANT EXCERPTS FROM

AGREED STIPULATED FACTS OF ZURICH AMERICAN INSURANCE COMPANY AND LEXINGTON COAL COMPANY, LLC

Comes Zurich American Insurance Company ("Zurich"), by and through counsel, and Lexington Coal Company, LLC ("Lexington Coal"), by and through counsel, and for their joint stipulations of facts and exhibits required by the Order to Prepare Joint Stipulations of Fact and List of Stipulated Exhibits [doc. no. 7071] agree and stipulate as follows:

* * *

51. As of September 2003 the Debtors had paid all amounts billed to them by Zurich except they had not paid a renewal premium.

* * *

69. All monthly premiums due under the June 25, 2004 Amended Order were timely paid, although some of the premiums for extensions granted were not paid.

* * *

78. Even after the Debtors did not make disputed payments to Zurich, insurance coverage was still provided. Zurich put the Debtors on a "pay as you go plan". After a default, Zurich had the right to terminate the financial accommodations provided under the Deductible Agreements and to declare all amounts due. [Ex. 21] (Zurich Response, Ex. Y, p. 2.) Zurich did not ultimately take such action.

* * *

83. As indicated in the notices of effective date of the Plans (doc. Nos. 4220 and 4221), as of September 30, 2004, the Debtors closed the sale of their assets to the approved purchasers (the "Sale"), and the Plans became effective. As of the closing, the Debtors were deemed dissolved in accordance with the Confirmation Orders. (*See* Reorganization Plan Order L.2(z) and Liquidating Plan Order L.2(aa)).

* * *

94. The Zurich Filed Claim was filed as a protective measure to ensure payment of administrative expenses incurred by Zurich in the event that the surety bonds and other security provided by the Debtors to Zurich to secure payment of insurance deductibles owed by the Debtors to

Zurich are ultimately dishonored. (Zurich Filed Claim Addendum, ¶ 1.)

* * *

101. Zurich acknowledges that it has no liability for claim payments below the deductible limits on general liability policies. (*See* Zurich Response at pp. 39-40.)

102. The Zurich Filed Claim included as part of the total Administrative Expense Claim $3,050,667 in potential liability related to general liability policies. (Zurich Filed Claim Addendum, § 5, p. 2.) Zurich acknowledged in the response this was not correct. (Zurich Response, p. 40.)

* * *

122. Zurich asserts that the deductible payments previously received by Zurich ($8,640,396.24) and third-party administrators ($885,659.00) ([Ex. 81] (ZUR 003073-74 and 4416-17) (Ex. G to the LCC Reply)) from the Debtors total $9,526,055.24 (the "Expense Offset"). Zurich states that it does not have records related to payments to third-party administrators because these are records that are kept by the Debtors or the third-party administrators. Therefore, Lexington Coal agrees to accept these amounts as the minimum amounts for such receipts and reserves the right to seek back-up support if this matter proceeds to a hearing on the allowed amount of the Zurich Claim.

* * *

134. The amount of the administrative expense claim as described in the Zurich Response was calculated by taking the Current Ultimate Loss

Projection minus collateral or loss fund and payments made by the Debtors for deductibles in the past. (Zurich Response, pp. 2, 35-36.) In the Zurich Response, Zurich projects that the current deficiency amount is $14,593,567.79, which would have been substantially reduced if Frontier Insurance Company had paid the surety bonds.

135. The Statement of Account printed 06/03/05 and attached to the Zurich Response at Exhibit GG (ZUR 004420) [Ex. 29] shows the unapplied escrow is $23,048,145.97 (the "Loss Fund").

* * *

138. The vast majority of the Current Ultimate Loss Projection is for Workers' Compensation. The following chart is a list of those policies, their deductibles and aggregates and identifies where in the production by Zurich, the deductibles and aggregates for calculating the Ultimate Loss Projection can be found. [chart omitted]

* * *

173. An ultimate loss projection is a report prepared by actuaries at Zurich (in the case of Horizon, Stephen Moffett created the Ultimate Loss Projection). The preparation of ultimate loss projection reports is within the scope of his regularly conducted duties on behalf of Zurich. Zurich creates, maintains and relies upon these reports in their ordinary course of business. As indicated below, the ultimate loss projections are actuarial analyses of the projected ultimate cost made on a regular periodic basis which employ information provided by

the insured and updated loss information. The Horizon Ultimate Loss Projection is maintained at Zurich and is stored electronically in Zurich's computer system in the course of Zurich's regular course of business.

130 (5)

No. 08-1254

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IN THE
Supreme Court of the United States

ZURICH AMERICAN INSURANCE COMPANY,
Petitioner,
v.
LEXINGTON COAL COMPANY, LLC,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

Before the decision below, it was settled law that when a creditor provides goods or services to a debtor in bankruptcy, its claim for payment is entitled to administrative-expense priority. As this Court held in *Reading Co.* v. *Brown*, 391 U.S. 471, 483 (1968), costs "ordinarily incident to operation of [the debtor's] business" receive administrative priority. That priority is critical: without it, parties would be unwilling to risk dealing with debtors. And without the goods, services, and credit necessary to operate their businesses during bankruptcy, debtors would be unable to reorganize, or even liquidate in an orderly fashion—frustrating the

basic purpose of bankruptcy and harming debtors and creditors alike.

The lower court acknowledged that the insurance Zurich provided "was critical to the Debtors' operations. Without [it], the Debtors would have been unable to operate their business[.]" Pet. App. 10a-11a. Yet it held that the deductibles the debtor was contractually obligated to pay for that insurance—obligations the court found "will inevitably arise" and "reach well into the millions of dollars," *id.* 28a n.17—were not administrative expenses. It reasoned that because the deductibles would not come due until after the debtor's liquidation, their payment would not benefit the estate. *Id.* 27a, 33a. Accordingly, it concluded, Zurich could not recover for the deductibles in bankruptcy, but only from the post-liquidation debtor—a "right to recover [that] exists in theory but is not enforceable in practice." *Reading*, 391 U.S. at 478.

That reasoning cannot be reconciled with *Reading*'s core holding: in evaluating whether a claim warrants administrative priority, the question is not whether *payment* of the claim would benefit the estate, but whether the claim stems from the debtor's operations during bankruptcy. And it is in square conflict with decisions of other courts of appeals recognizing that *all* obligations relating to a debtor's operations during bankruptcy are entitled to administrative priority, even if the debtor liquidates before those obligations would otherwise mature. The Sixth Circuit's conclusion that Zurich's claim for deductibles would not arise until after the debtor's liquidation, when it would mature under state law, likewise conflicts with decisions of other courts of appeals holding that unmatured claims—including contract claims—are nonetheless claims entitled to payment in bankruptcy.

Respondent Lexington attempts to distract attention from these important legal questions by repeatedly sounding two themes: that this case is a mere contract dispute controlled by the terms of the insurance policies; and that the issue presented is "narrow," "rare," "unique," and limited to these specific facts. Each of these contentions is wrong. This case does not present a question of contract law, but a question of bankruptcy law: whether obligations arising from the debtor's conduct during bankruptcy, but maturing only later, are nonetheless claims in bankruptcy entitled to administrative priority. And, far from being limited to the facts of this case, this question arises in a wide variety of circumstances—including, for example, on-going environmental obligations arising from the debtor's operations in bankruptcy. *See* State Amici Br. 18-19.

As the amici demonstrate, the questions presented here are critically important to creditors, shareholders, and employees of companies in bankruptcy—as well as those companies themselves. In light of the nation's economic crisis and the wave of bankruptcies of major corporations that has already begun, this Court should resolve these issues now.

I. THE COURTS OF APPEALS ARE DIVIDED ON WHETHER FUTURE OBLIGATIONS ARISING FROM A DEBTOR'S CONDUCT DURING BANKRUPTCY ARE ADMINISTRATIVE EXPENSES

Zurich's petition demonstrated that the decision below squarely conflicted with decisions of the First, Second, and Fourth Circuits: *In re Hemingway Transport, Inc.*, 993 F.2d 915 (1st Cir. 1993); *In re Klein Sleep Products, Inc.*, 78 F.3d 18 (2d Cir. 1996); *In re Merry-Go-Round Enterprises, Inc.*, 180 F.3d 149 (4th Cir. 1999). Lexington attempts to distinguish these cases

by arguing that they arose on different facts. That is irrelevant. Each case presents the same legal question: whether obligations arising from the debtor's operations during bankruptcy are entitled to administrative priority even if the debtor liquidates before those obligations would otherwise come due. And each reaches a result that cannot be reconciled with the Sixth Circuit's holding here.

Lexington first argues (Opp. 12-13) that *Hemingway* considered "post-confirmation obligations in connection with environmental obligations under CERCLA," and "[t]his case has nothing to do with CERCLA liability." To be sure. But Lexington does not dispute the key points that put *Hemingway* squarely in conflict with the decision below: The claimant there, Juniper, which purchased contaminated property from the debtor during its bankruptcy, sought administrative-expense priority for environmental clean-up costs that would come due, if at all, only after confirmation, that it might never incur, and whose amount was uncertain. The First Circuit rejected the argument that administrative priority was unavailable because future clean-up would not benefit the estate, holding that the proper inquiry was whether the *consideration* received from Juniper (the contaminated property's purchase price) benefited the estate. And it granted administrative priority to the estimated future clean-up costs. 993 F.2d at 929-930, 934. There can be no doubt that Zurich would have prevailed under this analysis.

Lexington's only other attempt to distinguish *Hemingway* is to quote a passage from that decision—"[o]nly 'actual' administrative expenses, not contingent expenses, are entitled to priority payment under ... §503(b)(1)(A)," 993 F.2d at 930—that Lexington contends (Opp. 13-14) supports the Sixth Circuit's conclu-

sion that future payment obligations cannot be administrative expenses.

Lexington misunderstands that passage, which, as its context makes clear, addresses an entirely different issue. Under CERCLA, both the debtor and Juniper were potentially liable for clean-up costs. The First Circuit thus had to determine whether Juniper's claim for future clean-up costs should be disallowed under §502(e)(1)(B), which (to avoid double recovery) requires disallowance of contingent contribution claims by entities that are co-liable with the debtor. If Juniper were co-liable with the debtor under CERCLA, its "contingent" claim for future clean-up costs could not be allowed. The passage on which Lexington relies simply clarifies that the §502(e)(1)(B) limitation on allowance of "contingent" claims applies to administrative expenses as well as pre-petition claims.

But the First Circuit made perfectly clear that if Juniper surmounted §502(e)(1)(B) by proving that it was *not* co-liable with the debtor, its claim for future clean-up costs would receive administrative priority despite being "contingent." The court's holding is unmistakable: if §502(e)(1)(B) does not apply, Juniper's "claim for past *and future* response costs should be estimated and allowed as administrative expenses entitled to priority." 993 F.2d at 934 (emphasis added); *see id.* at 936. The Sixth Circuit's decision is in direct conflict with that holding.

Lexington similarly attempts (Opp. 15-16) to limit *Klein Sleep* and *Merry-Go-Round* to their facts, arguing that each turned on an express contractual provision for acceleration of future rent obligations in case of breach. Initially, *Klein Sleep* nowhere indicates that the lease there contained any such provision. More

fundamentally, neither decision focused its analysis on the lease's terms or framed the question as one of contract law. Rather, each stands for the proposition that, when the debtor enters a contract during bankruptcy, "*all* liability under the [contract]" is an administrative expense. *Klein Sleep*, 78 F.3d at 22.

Indeed, both *Klein Sleep* and *Merry-Go-Round* rejected the precise arguments Lexington advanced, and the lower court adopted, here. In *Klein Sleep*, the trustee contended that after the debtor decided to liquidate and the trustee surrendered the premises, the estate derived no benefit from the lease, and future rent thus was not an administrative expense. That argument, the Second Circuit explained, "relies on an unduly narrow view of the benefit conferred on an estate when a trustee assumes" a contract. 78 F.3d at 24. Because the lease was assumed during bankruptcy and the debtor enjoyed its benefits before liquidating, the landlord was entitled to administrative priority for *all* lease obligations.

Merry-Go-Round similarly held that future rent under a lease assumed and then repudiated following a decision to liquidate was an administrative expense. It reasoned that the expense was "actual" because it "arose out of a post-petition transaction" with the debtor, and "necessary" because the lease benefited the debtor before liquidation. 180 F.3d at 157-158. "If landlords ... are not guaranteed to receive ... administrative priority on future rent, then they would have little incentive" to do business with debtors. *Id.* at 158. Far from being limited to its facts, the court explained, "this same argument could be equally applied to any other ... executory contract." *Id.*

This case is no different from *Klein Sleep* and *Merry-Go-Round*. Here, as there, the debtor assumed a contract necessary to continue its business in bankruptcy. Here, as there, the reorganization failed and the debtor liquidated, leaving it unable to fulfill its contractual obligations. Here, as there, the contract nonetheless conferred an unmistakable benefit upon the debtor's estate, and—under the reasoning of the Second and Fourth Circuits—all liability under the contract is thus entitled to administrative priority.

Ultimately, Lexington's arguments reduce to one mistaken assertion: that a claim's allowability and priority are controlled by the contract's terms, and that Zurich could not "accelerate" the date the deductibles would come due under the policies by asserting a claim for those deductibles in bankruptcy. That contention reflects a thoroughgoing misunderstanding of how bankruptcy works. Because bankruptcy's purpose is to distribute a limited estate among all identifiable creditors, most courts of appeals treat unmatured or contingent payment obligations, including obligations under a contract, as claims in bankruptcy. *See, e.g., In re Stewart Foods, Inc.*, 64 F.3d 141, 144 (4th Cir. 1995) (a creditor's pre-petition claim for future payments under a contract "is not defeated simply because his right to the individual payments had not yet become due as of the date of the bankruptcy filing"); Pet. 21-29. That is not an improper "acceleration" of the contract's payment terms, but simply a function of bankruptcy's requirement that all claims be liquidated by a date certain. The question here is whether administrative expenses—which are merely post-petition claims—should be treated any differently. The First, Second, and Fourth Circuits have concluded that they should not be, and that all obligations stemming from a debtor's con-

duct during bankruptcy, including future-arising obligations, are administrative expenses. The Sixth Circuit's holding cannot be reconciled with those decisions.

II. THIS CASE IS AN APPROPRIATE VEHICLE FOR RESOLVING THE ENTRENCHED SPLIT OF AUTHORITY REGARDING WHEN A BANKRUPTCY CLAIM ARISES

As Zurich's petition demonstrated, the courts of appeals are in disarray regarding one of the most basic questions in bankruptcy: when a "claim" arises that can be asserted—and potentially discharged—in bankruptcy. By holding that Zurich could not recover for future deductibles in the bankruptcy, but could proceed only against "the dissolved estate," Pet. App. 24a, the court below concluded that Zurich's claim would arise only after the bankruptcy, when a right to payment would accrue under state law. *See also id.* 33a-34a; Pet. 21-22. In doing so, it adopted the minority position previously endorsed by the Third Circuit, and exacerbated the existing split of authority.

Lexington readily acknowledges (Opp. 21-22) the long-standing and entrenched division of authority on this critical issue of bankruptcy law. And it does not deny that the lower court held that Zurich's claim would arise only post-bankruptcy—indeed, it endorses that position. Opp. 32 ("[T]he obligation to reimburse the deductibles will not even arise by contract until [after confirmation]. Claims incurred post-confirmation are simply ordinary creditor claims against the post-confirmation debtor."). Instead, Lexington contends—in an argument spanning many pages, but ultimately reducing to a single point—that the split is not implicated here because it involves only the construction of §101(5), which defines "claim" to include "unmatured" and "contingent" rights to payment. To receive admin-

istrative priority, Lexington argues, a claim cannot be unmatured or contingent.

Lexington's contention that the split is not implicated is simply wrong. The court below did not hold that Zurich had a claim in bankruptcy while denying that claim administrative priority; rather, it held that Zurich would have a claim only after bankruptcy, against the "dissolved estate." Pet. App. 24a. It thus took sides in the split regarding when a claim arises.

Even if the court had held only that unmatured obligations cannot be administrative expenses, however, this case would still implicate that split. Administrative expenses are simply claims that arise during bankruptcy. Pet. 22-23. And, as discussed in Part I, other courts have held—contrary to Lexington's position—that administrative expenses include unmatured obligations arising during bankruptcy. If those courts are correct, this case presents the question whether Zurich's claim for future deductibles arose, and could thus be asserted as a priority claim, during bankruptcy. If they are not correct, this case still presents the question whether Zurich could assert a non-priority claim in bankruptcy. In short, it makes no difference that this case involves an administrative-priority claim: to have an administrative claim, Zurich must first have a claim under §101(5). This case thus enables this Court to resolve the question that has long divided the courts of appeals: when a claim—be it a pre-petition claim or a post-petition administrative claim—arises under the Bankruptcy Code.[1]

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[1] Lexington also points (Opp. 23-24) to another Sixth Circuit case, *In re Sunarhauserman, Inc.*, 126 F.3d 811, 818 (6th Cir. 1997), that contains a sentence that could be read to reject the

III. THE DECISION BELOW WRONGLY RESOLVES AN IMPORTANT ISSUE AND WARRANTS IMMEDIATE REVIEW

The Sixth Circuit's decision is a dramatic departure from the basic principles set out by this Court. As *Reading* held, administrative expenses—the "'actual and necessary costs'" of preserving the estate—include all "costs ordinarily incident to operation of a business." 391 U.S. at 483. The deductibles here are the debtor's payment for insurance necessary for its business. Under *Reading*, those obligations are entitled to administrative priority.

Lexington argues (Opp. 17) that *Reading* is relevant only to "a select group of difficult to classify claims," and has no bearing on contract claims. That is untenable: *Reading* construed the administrative-priority statute in light of basic bankruptcy purposes. 391 U.S. at 475-476. That construction governs *all* administrative expenses, not some "select group." And it refutes the lower court's conclusion that the deductible obligations conferred no "benefit" on the estate; the state-mandated *insurance* unquestionably conferred a benefit by permitting the business to operate. *See id.* at 483; *see also, e.g., In re H.L.S. Energy Co.*, 151 F.3d 434, 437-439 (5th Cir. 1998) (satisfying obligation to plug unproductive oil wells "benefited" estate by permitting operation of business in accord with state law).

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state-law accrual theory. But as the petition explained (Pet. 25 n.9), that sentence, which did not discuss *In re M. Frenville Co.*, 744 F.2d 332 (3d Cir. 1984), or any other decision in the split, has been disregarded by subsequent Sixth Circuit decisions—the decision below and *CPT Holdings, Inc.* v. *Industrial & Allied Employees Union Pension Plan*, 162 F.3d 405 (6th Cir. 1998), which have expressly or implicitly endorsed the Third Circuit's *Frenville* line of authority.

Moreover, the Sixth Circuit's incorrect decision will have serious and broad repercussions. As the State amici demonstrate, it threatens to disrupt the sound operation of bankruptcy law at precisely the time when our nation's economy depends on its smooth functioning. Insurers will be unwilling to offer low-cost deductible policies, endangering debtors' ability to obtain necessary insurance. More generally, lenders and vendors will hesitate to deal with debtors if all obligations arising from those dealings will not receive priority.

Lexington attempts to blunt the impact of the Sixth Circuit's misguided decision by repeatedly claiming that the issue presented is "narrow" and "rare." Not so. Initially, Lexington is wrong that the policy here, under which the insurer advances deductibles, is "unique." Opp. i. It is, in fact, a common arrangement when the insured is a company rather than an individual. Indeed, some states *require* such an arrangement for workers' compensation insurance. *See* Cal. Ins. Code §11735(e)(3). Moreover, as the State amici explain (Br. 17), the same issues arise with respect to self-insured companies, which include such large companies as Chrysler and General Motors, both now in bankruptcy. When such companies become insolvent, state funds pay injured workers and assert claims in bankruptcy. If such claims did not receive administrative priority, many state funds would face insolvency themselves.

More broadly, on the Sixth Circuit's view, any vendor providing goods or services to a debtor while requiring payment in the future would risk going unpaid if the debtor liquidates before payment would otherwise come due. And, as the State amici explain (Br. 18-19), the same legal question arises in scenarios involving involuntary creditors, such as environmental clean-

up costs that result from a debtor's operations in bankruptcy, but continue after the bankruptcy's conclusion. Under the Sixth Circuit's reasoning, States (or the EPA) could never recover in bankruptcy for such future clean-up costs, and if the debtor liquidates, would have no effective recourse against it.

Finally, Lexington repeatedly emphasizes Zurich's attempts to obtain collateral to secure the debtor's obligations, arguing that the issue presented arises only because some collateral failed. But the collateral is entirely irrelevant to whether Zurich has a claim for deductibles entitled to administrative priority. Initially, Lexington's focus on collateral begs the question presented: if, as Lexington contends, Zurich has no claim in bankruptcy for the deductibles, but can proceed only against the dissolved post-bankruptcy entity, collateral from the debtor would not protect Zurich. Moreover, contrary to Lexington's suggestion, administrative creditors routinely seek and obtain collateral, in part to protect against administrative insolvency—the risk that the estate will have insufficient assets even to pay administrative claims. Indeed, most loans to debtors-in-possession are secured by collateral. *See* 11 U.S.C. §364(c) (contemplating that debtors-in-possession will obtain secured loans). But it does not follow that such lenders' claims do not enjoy administrative priority. In short, the existence of collateral has no bearing on the important unresolved issues presented here—issues that arise in a wide variety of bankruptcy cases and merit this Court's review.

CONCLUSION

The petition should be granted.

Respectfully submitted.

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178 No. 08-1254

IN THE
Supreme Court of the United States

ZURICH AMERICAN INSURANCE COMPANY,

Petitioner,

v.

LEXINGTON COAL COMPANY, LLC,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

BRIEF FOR THE STATES OF MICHIGAN, ALASKA, ARIZONA, HAWAII, INDIANA, MARYLAND, MASSACHUSETTS, MISSOURI, NEVADA, NEW MEXICO, TENNESSEE, UTAH, AND WASHINGTON AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED

The Bankruptcy Code provides that administrative expenses—claims to payment of expenses that arise during a bankruptcy case, including the "actual, necessary costs and expenses of preserving the [bankruptcy] estate," 11 U.S.C. §503(b)(1)(A)—are entitled to priority over the claims of other unsecured creditors, *see id.* §507(a). That priority recognizes both the need to convince parties to do business with the debtor during the case, and the possibility that the debtor's operations may adversely impact other parties and give them a right to be fully compensated. In light of those twin purposes, the questions presented are:

1. Whether the Sixth Circuit erred in holding that administrative-expense priority extends only to payments made prior to confirmation, even if later payments arise directly out of interactions with the debtor during the case – a holding that conflicts with the law of three other Circuits.

2. Whether the Sixth Circuit erred in holding that a claim against a bankruptcy estate for an administrative expense arose only when an enforceable right to payment accrued under nonbankruptcy law post-confirmation, even though the transaction giving rise to the right to payment occurred prior to confirmation – a result in conflict with the law of six other Circuits.

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INTERESTS OF THE AMICI CURIAE

The *Amici Curiae* States file this brief in support of petitioner to underscore the need for clarity with respect to the important questions presented herein and to urge that the Court resolve these issues in a way that provides appropriate protection for the interests of creditors and the debtor alike.

The Bankruptcy Code utilizes a broad definition of "claims" (of which administrative expenses are a subset) as a way of resolving in one time and place as much as possible of the universe of obligations facing the debtor.

The courts have, in the main, constructed a test for determining when a claim arises that honors that intent, while recognizing the constitutional limits that must exist on the scope of a "claim." The decision below unduly narrows the definition of a claim in ways that affect not only the allowance of administrative expense claims but all claims generally. In doing so, it introduces unnecessary confusion into an area that requires careful attention to competing interests.

The significance of the decision in dispute to *Amici Curiae* States is difficult to overstate. The nation's economic crisis and the continuing stress on all aspects of the automotive industry have paved the way for a surge of new bankruptcies involving large employers. Chrysler, LLC, with 38,500 hourly and salaried U.S. workers is one such employer. The *Amici Curiae* States are concerned with enforcing state laws that assure that injured employees who are covered by their employer's workers' compensation insurance, such as that provided by the Petitioner, actually receive their workers compensation benefits.

They are equally concerned with protecting employees injured at work while an employer is in bankruptcy proceedings regardless of whether that employer is illegally uninsured or has secured workers' compensation coverage through an insurance carrier, State-provided coverage, or by being self-insured. Further, they are also deeply concerned about analogous issues that arise with respect to environmental remediation costs that arise from the debtors' actions during a bankruptcy case but continue to accrue after a case terminates. In all of these scenarios, the Sixth Circuit's holding would result in downgrading the priority of the claim – or, indeed, denying allowance of the claim altogether, based merely on the happenstance of whether payment for such obligations comes due during or after the bankruptcy case.[1] For all of those reasons, the *Amici Curiae* States have a deep interest in the outcome of this case.

INTRODUCTION

The bankruptcy system created by title 11 of the United States Code[2] pursues several goals simultaneously. It grants individual debtors a "fresh start" by relieving them of debts through the discharge and exemption processes. It assists businesses to reorganize, thereby providing greater value to creditors and continued employment for workers. Finally, it seeks to divide the debtor's assets fairly among competing groups of creditors in accordance

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[1] There are other fact patterns where the Sixth Circuit's analysis could prove harmful, but these are the most obvious and illustrate the problems with that analysis.

[2] All section references hereafter, unless otherwise stated, are to title 11 of the United States Code, commonly referred to as the Bankruptcy Code.

with Congress' priorities—priorities that were chosen based on many criteria, including the importance of the particular debt (i.e., domestic support obligations, employee wages and benefits, and taxes) and the timing of the debt.

In particular, the Bankruptcy Code gives special priority to debts arising after the petition date that are based on dealings with the debtor in possession. These debts, which are treated in Sections 503 and 507 of the Bankruptcy Code, are referred to as administrative expenses. Such expenses are given the first priority for payment in corporate bankruptcies for very pragmatic reasons – namely, that goods, services, and credit provided during the bankruptcy are necessary to "preserve the estate," so it can be maximized for the benefit of the creditors. The drafters of the Code understood that providers of such necessities would refuse to deal with entities in bankruptcy absent such protection and provided that priority to allow the reorganization to succeed.

In addition, while, in general, administrative expenses are commonly described as those that "benefit" the estate, this Court has also held that they must include those costs that are "ordinarily incident to operation of a business." *Reading Co. v. Brown,* 391 U.S. 471, 483 (1968). In that case, this Court held that administrative status must be accorded to the claims of a neighboring business that was damaged by a fire that began on the debtor's premises. This Court rejected the debtor's argument that it need not pay those costs in full because they did not "benefit" the estate, holding that that argument took too narrow a view of how and when the "benefit" should be assessed. Rather, this Court held, if a debtor and its general creditor body choose to continue the operation of the

company in order to preserve and potentially expand the estate assets, they must accept the corollary obligation to pay for the costs imposed on others by those operations. *Id.* at 478. The benefit to the estate arises when the decision is made to continue to operate the business; the debtor and other creditors cannot use hindsight to impose the negative consequences of such operations on those who have "had an insolvent business thrust upon it by operation of law." *Ibid.*

The *Amici Curiae* States believe it is critical to strike a proper balance in reviewing administrative expense claims. The standard for granting such status must be reasonably strict so that they do not swallow up all of the assets of the estate to the detriment of those with pre-petition claims. At the same time, though, they must not be denied if properly owed. Debtors must be able to guarantee that they can offer full payment of such expenses to those with whom they need to do business in order to continue in operation. Creditors and other parties that engage in transactions with the debtor, or are injured by its operations, have a right to receive the full payments to which they are entitled. Creditors will not do business with debtors if they are forced to provide involuntary subsidies to them; nor should other parties who have losses "thrust upon [them]" by the debtor's actions be denied compensation for those losses.

The ramifications of the Sixth Circuit's holding apply not only in the specific context here – denial of priority status for deductibles incurred under workers' compensation policies assumed during the case – but in several other contexts as well that are of concern to the *Amici Curiae* States. The court's conclusion that costs arising out of post-petition transactions with the debtor have administrative status only if the payment

obligations come due prior to termination of the case would deny such status to future medical costs and wage loss for employees of self-insured debtors who are injured during the case but whose medical expenses continue after the bankruptcy. Similarly, when environmental obligations arise from a debtor's actions during the bankruptcy, the remedial costs to clean up the contamination should be given administrative priority even if some of those costs will not need to be paid until after the bankruptcy's conclusion. Such ongoing payments are often necessary to fully remedy the damage done to the environment by the debtor's conduct, since the clean-up often cannot be completed within the limited time period of a bankruptcy case. Under the Sixth Circuit's rationale such future costs—though stemming from the debtor's operations during bankruptcy—would receive no priority. Indeed, as discussed further below, under that analysis, such costs would likely not even be an allowable claim at all.

The rule adopted by the Sixth Circuit is also problematic because it leaves the priority of these claims within the debtor's sole control. Thus, under the Sixth Circuit's reasoning, the obligations owed in the *Reading* case could have been treated as nonadministrative, if the debtor had merely liquidated after destroying its neighbor's property, so that the remedial costs were not being spent during the reorganization case. A rule that allows such manipulation of costs arising out of the debtor's operations does not further the equitable considerations underlying the Code's priority provisions.

Similarly, the court's holding that the debtor's future duty to pay deductibles is not a claim in

bankruptcy because it would not be recognized under nonbankruptcy law until after the debtor was liquidated raises enormous concerns for any party doing business with or regulating the debtor during the bankruptcy case. Such a rule would mean that any party interacting with the debtor during the case must assume that it will not be paid for expenses that arise from transactions during the bankruptcy, but that do not come due until after confirmation. To protect themselves, such parties will need to take steps to deal with those costs such as demanding full payment up front, seeking security, or refusing to deal with the debtor at all – responses that will harm the debtor, rather than assist in its reorganization.

Finally, the Sixth Circuit's apparent adoption of the view that there must be a presently litigable cause of action under nonbankruptcy law before a claim exists deepens the long-standing and substantial conflict on that issue among the Circuits, as detailed in the Petitioner's brief, pp. 21-29.

As the nation's economic crisis brings a surge of new bankruptcies, time is of the essence. The *Amici Curiae* States submit that the issues raised by the Sixth Circuit's holdings in the decision below go to the most fundamental questions under the Bankruptcy Code – how to decide when a claim exists in order to determine its allowability and priority. Leaving these issues unresolved serves no one's interests. Because the resolution of these issues directly affects the interests of the *Amici Curiae* States, their citizens, and employees working within their borders, they respectfully urge this Court to grant certiorari.

ARGUMENT

The Sixth Circuit's Holding That Future Obligations Arising Out Of Conduct During The Bankruptcy Case Are Not Administrative Expenses Conflicts With Other Circuits And Harms Debtors and Creditors Alike.

The facts of this matter are simple – the debtor operated for an extended period of time after filing its bankruptcy petition. In order to do so legally, it was required to maintain workers' compensation insurance for its employees. It could have bought a "guaranteed cost" policy with no deductible. The premiums for that policy would undoubtedly have been an administrative expense, but choosing that option was not desirable because such policies are extremely expensive. Instead, it agreed, with bankruptcy court approval, to "assume" its existing policy.[3] That policy required it to pay an up-front premium to the insurer (i.e., the Petitioner here) and then to pay a deductible amount on each claim after the insurer had first paid the full amount to the worker. The total cost of the premiums and the deductibles was still less than the cost of premiums for a guaranteed-cost policy, so choosing this option provided added funds to the estate for other creditors. While the debtor was operating in Chapter 11, there was no question that it was obligated to reimburse the insurer for deductibles the insurer had already paid on account of workers' compensation claims and that the reimbursement obligation was an administrative expense – and such payments were

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[3] Assumption of a contract takes place under Section 365(a) of the Bankruptcy Code. If approved by the court, an assumed contract is treated as if it were entered into anew postpetition and costs incurred thereunder enjoy administrative-expense priority. *NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 531-32 (1984).

indeed made by the debtor. Had the debtor successfully reorganized – as was its intention when it filed – it would have been obligated to continue to pay the deductibles for claims that arose from events during the policy period after the petition date, but that were filed and paid after the confirmation date.

This case arose because the debtor could *not* reorganize, and instead (as often occurs) was forced to liquidate. The insurer could document with reasonable certainty that it would have future obligations for a significant number of additional claims arising under the policies assumed during the bankruptcy that would result in deductibles being owed (in the approximate amount of some $14 million).[4] When the insurer sought to have a claim for that amount treated as an administrative expense and paid (or reserved for) in the distribution of the debtor's estate, the Sixth Circuit held that the insurer had no administrative-expense claim because the debtor's obligation to reimburse the insurer for those deductibles did not arise until post confirmation.

It took that position for two reasons, both of which the *Amici Curiae* States disagree, and with respect to which there is considerable divergence in the Circuit Courts. First, it held that an

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[4] While there might be some dispute about the amount and certainty of the claim, those disputes are no different than those that might arise with respect to a similar prepetition claim. The definition of a "claim" under Section 101(5) includes "contingent," "disputed," and "unliquidated" claims, so there is nothing unusual about the fact that the bankruptcy court might be required to value a claim where there was still a degree of uncertainty about the precise amount that would be owed. There is no reason why making such determinations would be any more difficult for postpetition claims than prepetition claims.

"administrative expense" could only result from a transaction that benefited the estate and, once the estate terminated on the debtor's liquidation, then, *ipso facto*, nothing that happened could benefit that estate. Second, it held that there was no claim at the time of confirmation because no right to payment could accrue until the time the right to reimbursement came due under nonbankruptcy law; i.e., after confirmation and after distribution of the estate.

There is serious doubt as to the merits of the Sixth Circuit's position on both of those issues. Of more significance for the purpose of this filing is that the positions in the decision below put the Sixth Circuit in conflict with several other Circuits, as discussed in the Petitioner's brief. That conflict arises in large part from disagreement over fundamental questions about when a "claim" in bankruptcy arises – questions this Court has never directly addressed and that have divided the lower courts ever since the Bankruptcy Code was passed in 1978. This case presents this Court with a chance to address and resolve those important issues and provide much-needed guidance to the lower courts.

A. Limiting "claims" to rights to payment that have already accrued under State law is overly narrow.

The Bankruptcy Code defines "claims" in an exceedingly broad manner; i.e., a "claim" means any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5). The intent was that "all legal obligations of the debtor, no matter how remote or

contingent, will be able to be dealt with in the bankruptcy case." H.R. Rep. No. 95-595, at 309 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6266. The problem that has arisen upon closer analysis is that such a broad definition raises serious constitutional questions if applied to discharge claims that may still be contingent or where an injury may have not yet manifested itself. As a result, it is quite possible for a "claim" to exist under the literal terms of this definition, but for the potential claimant to have no idea of its existence, so that the party lacks adequate notice and ability to be heard in the bankruptcy. *In re Chateaugay Corp.*, 944 F.2d 997, 1003 (2nd Cir. 1991) (using example of debtor who has built 10,000 bridges, one of which may fail and kill 10 people, to illustrate problems with identifying whether "claims" could be said to currently exist and who would hold those claims.)

The courts have struggled with where to draw the line to determine when a claim "arises" where it is not yet a fully realized cause of action under nonbankruptcy law at the time the bankruptcy is filed, but the debtor has taken the actions that give rise to its liability. The most obvious example of this problem is the situation where the debtor manufactured and sold products prepetition, some of which were defective and could cause injuries. While a person owning such a product could be said to have a bankruptcy "claim" based on the contingency that the product might eventually cause harm, it would be unlikely that the person would have a state law claim under those circumstances. Similarly, the debtor may have exposed workers to a dangerous substance such as asbestos, but the person has not yet manifested disease. And, in the environmental context, the debtor may have allowed toxic substances to escape into the

environment, but the damage may not yet be known to environmental authorities or the damage may initially be limited before contamination has begun to spread. In each of those cases, the courts have discussed how to determine when the facts of the debtor's conduct have coalesced into a "claim" that must be handled within the bankruptcy process.

See, e.g. Epstein v. Official Committee of Unsecured Creditors of Estate of Piper Aircraft Corporation, 58 F.3d 1573, 1577 (11th Cir. 1995) ("debtor's prepetition conduct gives rise to a claim to be administered in a case only if there is a relationship established before confirmation between an identifiable claimant or group of claimants and that prepetition conduct") (planes with design defect); *Grady v. A.H. Robins Co., Inc.,* 839 F.2d 198, 202-03 (4th Cir. 1988) (claim can exist even though it "depends upon a future uncertain event, that event being the manifestation of injury from use of the Dalkon Shield. We do not believe that there must be a right to the immediate payment of money . . . when the acts constituting the tort or breach of warranty have occurred prior to the filing of the petition; . . . Congress has created a contingent right to payment."); *In the Matter of Crystal Oil Co.,* 158 F.3d 291 (5th Cir. 1998) ("regulatory environmental claim will be held to arise when 'a potential . . . claimant can tie the bankruptcy debtor to a known release of a hazardous substance," citing *In re Chicago, Milwaukee, St. Paul & Pac. R.R. Co.*, 974 F.2d 775, 786 (7th Cir.1992)) As Petitioner's brief explains (pp. 23-29), in addressing such questions, courts have adopted a variety of tests that consider the extent of the debtor's conduct, the current injury, if any, suffered by the potential claimant, the relationship between the debtor and the potential claimants, and the claimants' knowledge about the

possibility that they have suffered harm and need to file a claim. As described in *Chateaugay*, balancing these competing concerns requires line-drawing. But what is clear is that, in light of the breadth of the Bankruptcy Code's definition of claim, and its express inclusion of "contingent" and "unmatured" claims, few courts—indeed, only the Third Circuit and the Sixth Circuit here—have suggested that the existence of a currently enforceable state law cause of action is the dispositive factor for when a claim arises.

The Sixth Circuit's decision appears to be based on that narrow view of a claim – that there must be a present, fully ripened cause of action at the relevant moment (i.e, prepetition or preconfirmation). In doing so, it has placed itself at odds with numerous other Circuits. If that is indeed to be the rule within the Sixth Circuit, it will treat many issues differently from other Circuits and will create a distinctly nonuniform definition of which obligations will be treated within the bankruptcy process. In doing so, it dramatically constricts the "claims" that can be dealt with in bankruptcy and leaves many potential obligations outside the purview of the bankruptcy case. That result would conflict with Congress' intent to have bankruptcy proceedings reach as broadly as legally possible to resolve the debtor's legal obligations.

While the *Amici Curiae* States agree that the definition of a claim cannot be applied in a manner that would violate claimants' due process rights, the text of the Bankruptcy Code makes clear that the overly narrow definition adopted by the Third and Sixth Circuits is not appropriate or what Congress

intended.[5] The decision as to when facts have become sufficiently ripe and known to the claimant so as to have a claim arise is an issue that is at the heart of every bankruptcy case. That issue deserves to be heard and resolved by this Court and the decision below provides a suitable opportunity for the Court to address those issues.[6]

B. The Sixth Circuit's constricted reading of the administrative priority provision conflicts with the law of other Circuits and harms the interests of the *Amici Curiae* States.

As described in Petitioner's brief, the Sixth Circuit also erred, and departed from the governing law in other Circuits, by concluding that when a debtor purchases insurance (or any other necessity) to enable it to continue its business, payments that come due after the bankruptcy's conclusion are not entitled to administrative-expense priority.

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[5] Indeed, where there were doubts as to whether bankruptcy courts could constitutionally bring the rights of those exposed to asbestos but without manifested illnesses into the case, Congress created a specific mechanism – Section 524(g) – that addressed those due process issues and kept those claims in the case.

[6] It is possible that the Sixth Circuit intended to apply its narrow definition of a claim only to the subset of claims that are administrative expenses. If so, then the *Amici Curiae* States believe that certiorari should be granted, as further discussed below, to bring the law in the Sixth Circuit into accord with the treatment of similar administrative expenses in the other Circuits. There is no basis under the Bankruptcy Code to apply different standards to different types of claims and no indication that other Circuits agree that the criteria for determining when a claim is sufficiently concrete to have "arisen" should differ based on whether the events occurred before or after the petition was filed.

As discussed above, the debtor here purchased workers' compensation insurance in order to continue its business while pursuing reorganization. Accordingly, all of the debtor's obligations under the insurance policies, including its obligation to reimburse the insurer for deductibles paid in the future under those policies, are properly viewed as administrative expenses. Those rights all arose out of a single contractual transaction that created the parties' benefits and obligations when it was entered into during the case.

The situation here is no different than the analysis of the treatment of claims arising from breaches of prepetition contracts. The cases almost universally find that such breaches are allowed only as *prepetition* claims, even though the actual breach and loss occurred postpetition. *PBGC v. Sunarhauserman, Inc. (In re Sunarhauserman, Inc.)*, 126 F.3d 811, 818 (6th Cir.1997); *U.S. Through Agr. Stabilization and Conservation Service v. Gerth*, 991 F.2d 1428 (8th Cir. 1993) ("dependency on a postpetition event does not prevent a debt from arising prepetition"); *Matter of United Sciences of America, Inc.*, 893 F.2d 720, 724 (5th Cir. 1990) (claim was prepetition when item was charged to bank's account prior to bankruptcy filing although payment not made until postpetition); *In re Riodizio, Inc.*, 204 B.R. 417, 424, n.6 (Bankr. S.D.N.Y. 1997); *In re Chateaugay Corp.*, 87 B.R. 779, 796 (S.D.N.Y.1988). The same principle is embodied in the executory contract provisions of Section 365. That section provides that breaches of executory contracts that occur postpetition are to be deemed to have occurred prior to the petition date, thus automatically turning the breaches into prepetition unsecured claims.

In short, the standard rule is that breaches of a contract are treated as foreseeable, "contingent" or "unmatured" claims as of the date the contract was entered into. There is no reasonable basis for using a different standard to evaluate the accrual of claims with respect to *postpetition* contracts, merely because it would allow creditors to assert administrative status for their costs.

The Sixth Circuit's contrary holding thwarts the purpose of the administrative-priority provision: to ensure that parties who deal with the debtor during its bankruptcy receive the assurance that they will be paid before other creditors that is necessary to induce them to do business with the debtor. That common sense position has been adopted by at least three other Circuits with which the Sixth Circuit's holding conflicts as discussed in Petitioner's Brief, pp. 12-20.

The Sixth Circuit sought to explain its view by holding that the post-confirmation payment could not "benefit" the estate when it occurred after the estate no longer existed. But that merely begs the question of when the claim arises and, thus, when the requisite "benefit" should be analyzed. The prepetition contract cases show that the claim is normally treated as arising with entry into the contract. And, as *Reading* teaches, "benefit" flows from the debtor's ability to continue operating during the bankruptcy case. Accordingly, if the debtor enters into or assumes an insurance policy during the bankruptcy so that it can continue operating, then that is the date relevant to assessment of whether the transaction benefited the estate—not the date the payment for the insurance comes due. The insurer's claim for reimbursement of deductibles is substantively no different than a claim for premiums paid in installments—both are merely

the price paid by the debtor for the insurance coverage it needed to operate its business. And, as this Court has stated, "[i]t is of course obvious that proper insurance premiums must be given priority, else insurance could not be obtained." *Reading*, 391 U.S. at 483. The fact that certain premiums for insurance necessary to operate a debtor's business might come due after the debtor's liquidation should not change that analysis—and the same is true with respect to the deductible reimbursement obligations at issue here.

As with the definition of a claim, clarity in the treatment of administrative expenses is also of substantial concern to the *Amici Curiae* States. In this case, workers' compensation expenses were handled by way of an insurance contract. Many large companies, though, such as Chrysler and General Motors, are self-insured for such expenses. As a result, if an employee is injured or becomes ill from causes arising out of their work, those costs become a direct charge on the debtor that must be paid if the entity is to continue its self-insured status. Self-insured status, in turn, benefits other creditors in the case in that the payments made on employee claims are typically less than even the deductible policies used by the employer here. Moreover, maintaining employee morale and protecting the employer from the possibility of tort suits by employees (the bargain struck by workers' compensation laws) clearly benefits the estate. *See Howard Delivery Service, Inc. v. Zurich American Ins. Co.*, 547 U.S. 651, 662-64 (2006) where this Court held that workers' compensation plans were more in the nature of an employer benefit, rather than falling under the definition of "employee benefit plan" as set out in Section 507(a)(5).

Workers compensation claims are well-known for their long coattails. Often times, employee injuries or work-related illnesses can result in medical costs and wage loss for an extended period of time – a period that may last beyond the conclusion of the bankruptcy proceedings. Notably, there is no statute of limitations for bringing a workers' compensation claim. Under the Sixth Circuit's analysis, not only would such future payments not be administrative expenses, they would not even be allowable claims in the bankruptcy forum at all. Such a result would be deeply troubling to the *Amici Curiae* States with respect to the impact on their citizens and especially workers with work-related illnesses and injuries. Moreover, to the extent that they have sought to protect these workers by providing a guaranty fund to cover unpaid costs, the amounts owed with respect to a large self-insured employer, such as Chrysler, could quickly swamp the reserves in such a fund. The result would be to force other employers to pay much higher assessments (putting them under added financial strain), to place the burden on the taxpayers of the *Amici Curiae* States, or to leave the injured worker without any relief.

Further, the Sixth Circuit's decision directly conflicts with the intent of 28 U.S.C. § 959(b), which provides that a debtor in possession "shall manage and operate the property in his possession . . . according to the requirements of valid laws of the State in which such property is situated." For example, Chrysler, LLC is a self-insured employer in Michigan. If, during the bankruptcy proceedings, Chrysler stops paying its statutory workers' compensation obligations, Michigan can seek an order to enjoin Chrysler's business activities until it resumes paying its self-insured obligations or it makes alternative arrangements for workers' compensation coverage to return to

compliance—almost certainly at a much higher cost. Thus, it is critical that debtors in the ordinary course of business continue to process and pay workers' compensation claims in the states where they continue to engage in some level of business activity during bankruptcy proceedings. To do otherwise, may lead to a shut down of the debtors business operations under § 959(b), which—from the view points of debtors, creditors, employees, and even citizens thinking of buying a product made by a self-insured debtor in bankruptcy—could have a detrimental effect on the bankruptcy estate. Having once incurred those claims and processed them, a debtor should not then be allowed to artificially bifurcate the costs accruing from that claim and accept responsibility for paying only those amounts that come due prior to the termination of the case. Accordingly, the *Amici Curiae* States have a vested interest on behalf of their citizens, employers, and employees to urge this Court to grant certiorari.

Similar issues can arise in the context of environmental cleanup obligations that arise out of the debtor's operations. It is often the case that cleanup will need to continue after the termination of the bankruptcy process. In some cases, the cleanup will benefit the estate by salvaging a contaminated property and turning it into a usable asset. In other cases, the debtor may be obligated to carry out the cleanup, pursuant to 28 U.S.C. § 959(b) (which requires that a "debtor in possession . . . shall manage and operate the property in his possession . . . according to the requirements of the valid laws of the State in which such property is situated") and in accordance with the principles announced in *Reading Co.* Under that case, the debtor is obligated to pay the costs "ordinarily incident" to its operations as administrative expenses. As *Reading* showed, the

ability to continue doing business preserves the estate, and thus justifies administrative-expense treatment of the necessary costs arising out of the debtor's business while in bankruptcy – including the costs the debtor is lawfully obligated to incur to comply with Section 959(b).

Reading made clear that the "preservation" analysis has to be made using a global, prospective perspective, rather than the legalistic parsing that the Sixth Circuit used to bifurcate a unified transaction here. The *Amici Curiae* States believe that the same analysis applies so that, where a cleanup during the case is given administrative status, future costs to complete that cleanup must similarly be treated as administrative expenses. The Sixth Circuit's decision casts doubt on the resolution of all of these issues and will allow debtors to use bankruptcy to unfairly escape obligations that have accrued under the Bankruptcy Code pre-confirmation.

When a party assumes an executory contract like the insurance policies in this case, it must take it *cum onere*, accepting the good and the bad parts of the contract alike, including the obligation to pay *all* of the costs of the benefits it received. *NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 531-32 (1984). Similarly, when the debtor and its creditors allow a company to operate in bankruptcy, they must accept that doing so has both the potential for higher recoveries *and* the risk of loss. The approach taken by the Sixth Circuit forces entities that deal with the debtor during the case to shoulder an unacceptable risk. The result is that they will be far less likely to be willing to do business with entities in bankruptcy. That, in turn, makes it less likely that debtors will be able to reorganize successfully for the benefit of all their creditors.

In short, it is critical for those determining how and whether to deal with a debtor in possession to know if their claims will be entitled to administrative status and whether that right will change based on when the payments thereon are due. For those reasons, and because of the split in the Circuits, the *Amici Curiae* States respectfully submit that this Court should grant certiorari to answer these questions.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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IN THE
Supreme Court of the United States

ZURICH AMERICAN INSURANCE COMPANY,
Petitioner,

v.

LEXINGTON COAL COMPANY, LLC,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF OF *AMICUS CURIAE* NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA IN SUPPORT OF PETITIONER'S PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Sixth Circuit erred in holding that administrative-expense priority does not extend to *all* payments due under a contract entered into or assumed by the debtor during a bankruptcy case, in contravention of this court's holding in *Reading Co. v. Brown*, 391 U.S. 471, 483 (1968) (stating that the cost of insurance is properly an administrative expense) and the decisions of other Courts of Appeals.

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INTEREST OF THE AMICUS

Amicus curiae National Union Fire Insurance Company of Pittsburgh, PA ("National Union") respectfully submits this brief in support of Petitioner Zurich American Insurance Company ("Zurich"). Pursuant to Supreme Court Rule 37.2(a), all parties have consented to the filing of this brief.[1]

The issue in this case is whether a chapter 11 debtor is obligated to pay as an "administrative expense" the full cost of its workers' compensation insurance that it purchases on extended payment terms during its chapter 11 case, or whether the debtor may eliminate any outstanding payment obligation simply by confirming its chapter 11 plan before final payment is liquidated and due.

As an issuer of workers' compensation insurance, *amicus curiae* National Union is greatly affected by the decision in this case. National Union submits this brief in support of Zurich's petition for a writ of certiorari because the Sixth

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[1] Pursuant to Supreme Court Rule 37.6, *amicus curiae* states that no counsel for any party to this dispute authored this brief in whole or in part, and no person or entity, other than *amicus curiae*, made a monetary contribution to the preparation or submission of this brief. To the extent not previously filed, copies of the letters of the parties consenting to the filing of this brief are lodged herewith.

Circuit's decision effectively holds, in conflict with both Supreme Court precedent and decisions of other courts of appeals, that when a debtor in bankruptcy purchases workers' compensation insurance, the debtor need not pay for that insurance in full as an expense of administration. *Compare Reading Co. v. Brown*, 391 U.S. 471, 483 (1968) (stating that insurance purchased in bankruptcy "is an administrative expense payable in full . . . before dividends to general creditors" because otherwise necessary insurance "could not be obtained") *with* Pet. App. 1a, 3a.

Zurich provided economical workers' compensation and other insurance to Horizon Natural Resources Company and its affiliates (collectively, "Horizon") both before and after Horizon commenced its bankruptcy case. The insurance policies provided by Zurich were deductible policies, structured so that Zurich agreed to pay the full amount of the claims against Horizon up front and then bill Horizon for the deductible. Accordingly, under the policies, Horizon's payment obligations included (1) payment of premiums and (2) reimbursement of Zurich over time for the deductibles Zurich advanced. A workers' compensation insurer such as Zurich has a duty to pay workers' claims long after the policy period expires – indeed, long after the bankrupt debtor's bankruptcy plan is confirmed – as workers continue to need medical care or compensation for injuries sustained during the

policy period. Under this structure, rather than pay a single, large, fixed, up-front premium for the insurance, Horizon agreed to pay a small up-front premium and to reimburse Zurich for these "deductibles" as the payments were made far into the future.

The holding of the decision below, refusing to accord administrative expense priority to Horizon's reimbursement obligation for post-confirmation payments, effectively whipsaws Zurich, leaving it obligated to pay millions of dollars in claims while effectively denying reimbursement. Moreover, left in place, the decision will have far reaching consequences. A debtor in bankruptcy in the Sixth Circuit need only pay amounts that the insurer bills up until the time of confirmation of its plan, and not sums due thereafter. As a result, no insurer in the Sixth Circuit will be willing to provide insurance without demanding up-front payment or expensive forms of collateral to secure the debtor's obligations. Like Zurich, National Union is an insurance carrier that writes workers' compensation insurance, and thus, the question presented is of vital significance to it.

Consistent with Supreme Court Rule 37.1, the purpose of this brief is to bring to the Court's attention matters that are not addressed in the parties' briefs. This brief addresses the interpretation and application of section 503(b)(1)(A) from a distinct perspective, emphasizing how the Sixth Circuit's decision conflicts with settled

precedent and how the decision, if uncorrected, will frustrate Congress' intent to enable businesses to operate in bankruptcy. National Union respectfully submits that, in deciding the instant controversy, the Court would benefit from consideration of the matters addressed herein.

STATEMENT

This matter arises out of the chapter 11 bankruptcy case of Horizon.[2] In chapter 11 cases such as this one, a debtor may generally continue its business after commencing its bankruptcy case as a "debtor in possession" of property of the bankruptcy estate. 11 U.S.C. §§ 1101(1), 1107, 1108 (authorizing operation of business). Certain debts that the debtor incurs while operating in bankruptcy are classified as "administrative expenses," entitled to priority over other obligations. *Id.* §§ 503(b), 507(a)(2). Administrative expenses include the "actual, necessary costs and expenses of preserving the estate." *Id.* §§ 503(b)(1)(A), 507(a)(2). The priority granted administrative expenses "encourage[s] third parties to provide [businesses attempting to reorganize in bankruptcy] with necessary goods and servic-

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[2] When Horizon's effort to reorganize was not successful, it decided to liquidate, and in August 2004, it auctioned part of its business as a going concern and sold the rest of its assets to other buyers, including respondent Lexington Coal Company ("Lexington"). Pet. for Writ of Certiorari at 7.

es" in order to maximize the value of the estate for the benefit of creditors. *United Trucking Serv., Inc. v. Trailer Rental Co. (In re United Trucking Serv., Inc.)*, 851 F.2d 159, 161 (6th Cir. 1988).

Between 1998 and 2004, Zurich provided workers' compensation, general liability, and business automobile insurance to Horizon. Horizon filed for bankruptcy protection under chapter 11 of the Bankruptcy Code in November 2002. While Horizon attempted to reorganize, Zurich continued to provide insurance coverage to Horizon. Horizon could not legally operate in bankruptcy without workers' compensation insurance. *See* Ky. Rev. Stat. § 342.340; *see also* 28 U.S.C. § 959. As the district court recognized, "There can be no question that . . . the insurance coverage provided by the Zurich Policies was critical to the Debtors' operations," "both prior to and during the pendency of the bankruptcy." Pet. App. 10a-11a. Thus, the insurance coverage was "necessary," § 503(b)(1)(A), to the bankruptcy estate's operation of Horizon's business.

The Debtors' payment for this indispensable insurance was deliberately extended over time and designed to reimburse Zurich's actual payouts under the policies – all to reduce the burden on Horizon's cash flow and the overall cost of insurance. Under these sorts of "loss-sensitive" policies, including deductible policies, instead of Zurich charging a single, up-front premium to cover all risk and expense under the

policies, the parties agreed Zurich would pay claims and then be reimbursed by Horizon after payments were made. Pet. App. 8a ("On a deductible policy, the insured agrees to retain some of the risk of claims within the deductible layer. . . . In this instance, Zurich would advance the money to pay the losses and expenses and the Debtors would then reimburse Zurich when billed for the deductible costs under the policy.").

Under this payment structure, payments and reimbursements extend far into the future, long after plan confirmation. *Id.* at 9a ("although a claim may occur during a policy coverage period . . . costs may be incurred in connection with the prior coverage at some juncture after the coverage has expired; payments on some types of claims may extend over many years."). This can occur because, "[f]or example, a worker may suffer a compensable injury on December 1, 2002, but receive compensation payments and medical reimbursements over many years" because the condition "abate[s] but flares up in future years," or "the injury might be latent and manifest itself years later." *Id.* at 9a-10a. As the district court explained, "[b]ecause the later expenses stem from the original injury during the coverage period, the expenses will still fall under the domain of Zurich. And when dealing on such a large scale, these deductible expenses will reach well into the millions of dollars range." *Id.* at 28a n.17.

Such deductible policies are used in the vast majority of bankruptcy cases because non-deductible policies would impose "prohibitive costs" on debtors. *Id.* at 35a n.21. The difference in cost is staggering: Zurich estimated that Horizon would have paid <u>$50 million</u> as an up-front premium for one year as opposed to the <u>$10 million</u> premium for the actual policy. *Id.* Because of this enormous cost differential, "[n]either party suggests that guaranteed cost policies (i.e. non-deductible policies) . . . are . . . utilized to any meaningful degree by debtors in bankruptcy." *Id.* In addition to slicing the initial premium by 80%, the deductible structure also lessens the total cost of the insurance. *Id.* at 8a-9a ("because the Debtors purchased deductible policies, their agreed-upon premiums were reduced as a result of absorbing some of the risk to the insurer," and "[t]hese policies are generally less expensive than policies with no deductibles . . . even after considering the insured's exposure to deductibles.").

This arrangement is routinely used in bankruptcy to conserve cash while the debtor gets on its feet. The decision below makes this arrangement far more difficult and costly by effectively denying reimbursement of post-confirmation deductibles. As a result, debtors in bankruptcy will have to resort to other types of payment arrangements, either by paying the full cost of their insurance up-front or by providing

expensive cash-equivalent collateral to secure their obligations.

Although Horizon sold its assets to third parties, its obligations remained, including its deductible obligation to Zurich to pay its share of workers' compensation benefits that Zurich would continue to pay into the future. Zurich thus filed an application to allow Horizon's obligation as an administrative expense. Because an injured employee may be entitled to workers' compensation benefits for the duration of his or her disability for many years into the future, it is not possible to liquidate Horizon's reimbursement obligation with exact certainty prior to the actual, final cessation of benefits. However, using actuarial tables, it is possible to estimate the projected loss (the "Ultimate Loss Projection"), and either pay that amount to Zurich or, alternatively, establish a reserve to cover it, with payments made periodically from the reserve.

Zurich sought an administrative claim in the amount of $14,593,567.79 based on its Ultimate Loss Projection. The district court recognized that "there can be no question that Zurich will be forced to 'advance' a substantial portion, if not all, of the deductible obligations in question." Pet. App. 27a. Zurich's payments will "inevitably occur to some significant degree and unquestionably stem from insurance coverage during bankruptcy." *Id.* at 29a.

The district court's decision nevertheless denied recovery of this sum as an administrative expense because, in the court's view, an estimated expense could not be "actual" or "necessary," and "the payment thereof, when the obligations are realized, cannot act to preserve an estate that no longer exists," *id.* at 27a, i.e., when the claims are filed post-confirmation, *id.* at 28a-29a. On appeal, the Sixth Circuit affirmed, declining to "add anything of substance" to the district court's opinion. *Id.* at 2a.

SUMMARY OF ARGUMENT

Although Horizon obtained the full benefit of the insurance Zurich provided during the course of its bankruptcy case, it has sought to avoid paying the full price for that insurance as an administrative expense. The court of appeals concluded that only amounts liquidated by the time of confirmation of a plan qualify as administrative expenses. Moreover, it concluded that Zurich's request for reimbursement from Horizon for the cost of benefits Zurich paid post-confirmation on account of injuries sustained in the policy period cannot satisfy the section 503(b)(1) requirement that the cost "preserve the estate" because the estate ceased to exist at confirmation. These conclusions are unsound.

First, the decision below conflicts with extensive precedent from various courts of appeals by holding that the deductibles are not administrative expenses because *payment of the deduc-*

tibles would not benefit the bankruptcy estate. Instead, the court below should have asked whether the *insurance* benefited the estate, which the insurance obviously did. Various courts of appeals have properly applied the "benefit to the estate" test, focusing on whether the estate got something (*i.e.,* consideration – here, insurance) in exchange for its obligation to pay. In focusing on whether paying for the insurance would benefit the estate rather than whether the insurance benefited the estate, the decision below created a circuit split ripe for resolution by this Court.

Second, the decision below conflicts with Supreme Court precedent. In *Reading Co. v. Brown*, the Court rejected a narrow reading of the statutory term "actual and necessary costs," and interpreted the term as including "costs ordinarily incident to operation of a business, and not [] limited to costs without which rehabilitation would be impossible." 391 U.S. 471, 483 (1968). Workers' compensation insurance falls easily within the ambit of that description. Moreover, *Reading* stated that it was "obvious that proper insurance premiums must be given priority, else insurance could not be obtained." *Id.* *Reading* and its progeny eschewed narrow, formulaic readings of the "benefit to the estate" test, treating it properly as a means to an end of furthering the statutory purpose of reorganization. The decision below conflicts irreconcilably with that approach.

Third, the decision below creates a circuit split with two other courts of appeals in holding that the estate ceases to exist when the plan is confirmed. The Code does not provide that confirmation of a chapter 11 plan terminates the bankruptcy estate. Confirmation simply transfers property dealt with under the plan from the bankruptcy estate to the debtor or some other entity as specified in the plan. For confirmation of a plan to take place, the debtor must pay all administrative expenses in full, so it cannot also be true that confirmation excuses full payment. Indeed, the estate continues to exist and to hold, for example, unadministered assets, 11 U.S.C. § 554(d), even after the case is closed.

Fourth, the decision below conflicts with precedent from a sister court of appeals in suggesting that administrative expenses must be liquidated prior to confirmation in order to be paid. The Code provides expressly that a claim properly includes amounts that are "unliquidated." 11 U.S.C. § 101(5). The fact that Horizon was obligated to pay its deductible obligations over time, and that the precise amount of the payments were subject to change, does not make the obligations any less "actual" – it simply makes them "unliquidated."

Finally, left to stand, the decision below will have grave consequences. Debtors in bankruptcy may avoid paying for necessary insurance they purchase during the course of their cases. Insurers will therefore demand up-front pay-

ment or expensive collateral to secure the debtors' obligations. This will place workers' compensation insurance beyond the reach of many debtors, and because workers' compensation is required, those debtors will not be able to reorganize, in direct contravention of the policy of rehabilitation undergirding chapter 11 and section 503(b).

ARGUMENT

A. The Decision Below Conflicts with Extensive Precedent from Various Courts of Appeals by Holding that the Estate Does Not Benefit from the Payment of Amounts Due After Confirmation of Its Plan.

In bankruptcy cases, section 507 of the Bankruptcy Code governs the order in which claims are paid and affords the second highest priority to administrative expenses. 11 U.S.C. § 507(a)(2). Section 503(b)(1)(A) defines "administrative expenses" as "the actual, necessary costs and expenses of preserving the estate." *Id.* § 503(b)(1)(A). In order to qualify for administrative expense priority, courts have held that a claim must (1) "ar[i]se from a transaction with the bankruptcy estate" and (2) "directly and substantially benefit[] the estate." *Pension Benefit Guar. Corp. v. Sunarhauserman, Inc. (In re Sunarhauserman, Inc.)*, 126 F.3d 811, 816 (6th Cir. 1997).

As Zurich demonstrates in its Petition, the decision below erroneously holds that the deduc-

tibles are not administrative expenses because, assertedly, *payment of the deductibles* would not benefit the bankruptcy estate. The proper legal question is whether the *insurance* benefited the estate. Pet. for Writ of Certiorari at 12. As the district court itself pointed out, it obviously did. Pet. App. 10a-11a. National Union writes separately to point out that the decision below conflicts with precedent from this Court and other courts of appeals.

The "benefit to the estate" test does not require that the *payment* of an administrative expense must benefit the estate. Rather, it requires that the debtor's obligation to pay the expense arise from a transaction that benefited the estate. Expenses satisfy the traditional definition of "administrative expenses" so long as they arose from transactions that occurred between the creditor and the estate after the petition for bankruptcy was filed.

The test is whether the estate got something (*i.e., consideration* – here, insurance) in exchange for its obligation to pay. *Supplee v. Bethlehem Steel Corp. (In re Bethlehem Steel Corp.)*, 479 F.3d 167, 172 (2d Cir. 2007) ("[A]n expense is administrative only if it arises out of a transaction between the creditor and the bankrupt's trustee or debtor in possession, and only to the extent that the *consideration supporting the claimant's right to payment* was both supplied to and beneficial to the debtor-in-possession in the operation of the business.") (emphasis supplied)

(citation and internal quotation marks omitted); *CIT Commc'ns Fin. Corp. v. Midway Airlines Corp. (In re Midway Airlines Corp.)*, 406 F.3d 229, 237 (4th Cir. 2005) ("[C]ourts agree that an administrative expense has two defining characteristics," including "the *consideration supporting the right to payment* provides some benefit to the estate.") (emphasis supplied); *Isaac v. Temex Energy, Inc. (In re Amarex, Inc.)*, 853 F.2d 1526, 1531 (10th Cir. 1988) (describing consideration as "crucial" to the right to administrative expense priority); *In re Jartran, Inc.*, 732 F.2d 584 (7th Cir. 1984); *Cramer v. Mammoth Mart, Inc. (In re Mammoth Mart, Inc.)*, 536 F.2d 950, 955 (1st Cir. 1976) ("the case law teaches that a creditor's right to payment will be afforded [administrative expense] priority only to the extent that the *consideration* supporting the claimant's right to payment was both supplied to and beneficial to the debtor-in-possession in the operation of the business.") (emphasis supplied).

Aside from being settled law, this only makes sense. An estate never gets a benefit from the payment of a debt. It gets a benefit from what it received in exchange for its obligation to pay. In focusing on whether *paying* for the insurance would benefit the estate rather than whether the *insurance* benefited the estate, the decision below created a circuit split warranting certiorari review.

B. The Decision Below Conflicts with Supreme Court Precedent.

In *Reading Co. v. Brown*, the Supreme Court considered whether a tort obligation incurred during the course of a bankruptcy proceeding qualified as an administrative expense. 391 U.S. 471 (1968). The Court began by looking to the purposes of section 64(a) (precursor to section 503(b)), chapter 11, and the Bankruptcy Act as a whole. *Id.* at 476. Objecting to Reading's claim, the bankruptcy trustee argued for a narrow reading of "necessary," such that priority "should be given only to those expenditures without which the insolvent business could not be carried on." *Id.* at 477. The Court refused to read the statutory term narrowly, *id.*, concluding that the tort obligation did qualify as an administrative expense, *id.* at 485.

Turning to insurance, the Supreme Court stated that "the court below recognized that the cost of insurance against tort claims arising during an arrangement is an administrative expense payable in full under § 64a(1) before dividends to general creditors." *Id.* at 483. "It is of course obvious," held the Court, "that proper insurance premiums must be given priority, else insurance could not be obtained." *Id.* The Court rejected a narrow reading of "actual and necessary costs," stating that "'actual and necessary costs' should include costs ordinarily incident to operation of a business, and not be limited to costs without which rehabilitation would be im-

possible." *Id.* Workers' compensation insurance falls within this analysis, and the decision below, reaching the opposite conclusion, conflicts irreconcilably with *Reading.*

The *Reading* rule reaches to fact patterns beyond the tort context, *Texas Comptroller of Public Accounts v. Megafoods Stores, Inc. (In re Megafoods Stores, Inc.)*, 163 F.3d 1063, 1071 (9th Cir. 1998), including "situation[s] in which a bankruptcy estate may engage in activities regulated by state law while [attempting to avoid] the costs associated with that regulation," *Mass. Div. of Employment & Training v. Boston Reg'l Med. Ctr., Inc. (In re Boston Reg'l Med. Ctr., Inc.)*, 291 F.3d 111, 126 (1st Cir. 2002), or where "damage to the plaintiffs was caused by the postpetition operation of the estate's business." *Megafoods*, 163 F.3d at 1072 (holding that statutory interest was administrative expense) (citation & internal quotation marks omitted); *see also, e.g., In re H.L.S. Energy Co.*, 151 F.3d 434, 436 (5th Cir. 1998) (holding that costs incurred by the state in satisfaction of estate's post-petition environmental obligations were entitled to administrative expense priority); *Cumberland Farms, Inc. v. Florida Dep't of Envtl. Protection*, 116 F.3d 16, 21 (1st Cir. 1997) ("This was a post-petition claim incurred during the operation of [the debtor's] business while it was operating under Chapter 11. We think it would be fundamentally unfair to allow [the debtor] to flout Florida's environmental protection laws and escape paying a

penalty for such behavior."); *Potter v. CNA Ins. Cos. (In re MEI Diversified, Inc.)*, 106 F.3d 829, 832 (8th Cir. 1997); *Al Copeland Enters., Inc. v. Texas (In re Al Copeland Enters., Inc.)*, 991 F.2d 233, 240 (5th Cir. 1993) (holding that statutory award of interest constituted an administrative expense); *Alabama Surface Mining Comm'n v. N.P. Mining Co. (In re N.P. Mining Co.)*, 963 F.2d 1449, 1458 (11th Cir. 1992) ("We find that a policy of ensuring compliance by trustees with state law is sufficient justification to place civil penalties assessed for postpetition mining operations in the category of 'some cases' in which 'costs ordinarily incident to operation of a business' are accorded administrative-expense priority.") (citation omitted); *Cramer v. Mammoth Mart, Inc. (In re Mammoth Mart, Inc.)*, 536 F.2d 950, 955 (1st Cir. 1976) ("When the debtor-in-possession . . . accepts services from a third party without paying for them, the debtor-in-possession itself caused legally cognizable injury, and the resulting claims for compensation are entitled to first priority.").

In this case, the relevant administrative expense involves the cost of insurance that applicable state law requires a debtor to have in order to operate. As noted in the cases cited above, the full cost of complying with applicable regulatory requirements is properly an administrative expense.

Consistent with *Reading*, the courts cited above have eschewed narrow, rigid, or formulaic

readings of the "benefit to the estate" test, noting that it is merely a means to an end of furthering the statutory purpose of facilitating reorganization and preserving the value of an estate. *E.g.*, *H.L.S. Energy*, 151 F.3d at 437 ("The 'benefit' requirement has no independent basis in the Code . . . but is merely a way of testing whether a particular expense was truly 'necessary' to the estate."); *Mammoth Mart*, 536 F.2d at 954 (holding the application of the administrative expense priority "to Chapter [11] arrangements is primarily a means of implementing the statutory objective of facilitating the rehabilitation of insolvent businesses.").

In marked contrast, the decision below embraces an overly narrow reading of the "benefit to the estate" test, conflicting irreconcilably with *Reading* and other cases that have followed it.

C. The Decision Below Conflicts with Two Courts of Appeals and the Bankruptcy Code's Plain Text in Holding that the Estate Ceases to Exist When the Plan is Confirmed.

The decision below held that the expenses did not preserve the bankruptcy estate as the Code requires or meet the "benefit to the estate" test for administrative expenses because "[t]he moment Zurich is contractually permitted to seek reimbursement from the Debtors for the advanced deductibles, the estate will have al-

ready dissolved and the Debtors will cease to exist," so "payment of the claimed expenses will in no way act to preserve an estate when there is no estate to preserve." Pet. App. 29a; *see also id.* at 33a ("the payment of the deductibles, when and if they should arise . . . does not provide a direct and substantial benefit to, nor act to preserve, a bankruptcy estate when there is no longer an estate to benefit.").

However, this holding that the estate ceases to exist upon confirmation, such that there is "no longer an estate," conflicts with the Code, the decisions of two courts of appeals, and the leading bankruptcy law treatise. The Code does *not* provide that confirmation of a chapter 11 plan terminates the bankruptcy estate. Section 541 of the Code provides for the creation of a bankruptcy estate. 11 U.S.C. § 541. Notably, section 541 contains no provision terminating the estate at any given point in time. Rather, confirmation merely transfers property dealt with under the plan from the bankruptcy estate to the debtor or some other entity as specified in the plan. *Id.* § 1141(b). The debtor's *estate* is not discharged from its obligations. *Id.* § 1141(d)(3). Indeed, for confirmation of a plan to take place, the debtor must pay all administration expenses in full. *Id.* § 1129(a)(9)(A). Therefore, if a claim would otherwise be an administrative expense, *it cannot also be true that confirmation excuses full payment.*

Indeed, termination of the estate is inconsistent with the Code's plain text. Assets not administered in the bankruptcy proceedings remain "property of the estate." 11 U.S.C. § 554(d) ("property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate."). The estate continues to exist and to hold such un-administered assets even after the case is closed. This provision prevents a certain type of fraud – where the debtor fails to disclose an asset and then claims, after the conclusion of the bankruptcy proceeding, that the asset devolved back to the debtor out of the estate.

Thus, in *Chartschlaa v. Nationwide Mut. Ins. Co.*, 538 F.3d 116 (2d Cir. 2008), the debtor failed to disclose his interest in a corporation and a contract involving the corporation. The Second Circuit, reiterating that "undisclosed assets automatically remain property of the estate after the case is closed," *id.* at 122, held that the corporation, the contract, and a cause of action arising on the contract remained property of the bankruptcy estate even though the bankruptcy case had closed. *Id.* at 123; *see Sec. Bank v. Neiman*, 1 F.3d 687, 690 (8th Cir. 1993) ("The estate can continue to exist as a legal entity after confirmation even if it holds no property."); *In re Auto West, Inc.*, 43 B.R. 761, 764 (D. Utah 1984) ("all property of the estate that is not expressly abandoned or administered remains property of the estate."); *In re Dick*, Nos. 05-10881, 06-5286,

2007 WL 490948, at *1 (Bankr. D. Kan. Feb. 9, 2007) ("the overwhelming weight of case law precedent hold[s] that undisclosed assets in a bankruptcy estate remain assets of the estate. . . . '[A]n undisclosed asset of the Debtor . . . always remains property of the bankruptcy estate.'") (quoting *In re Thompson*, 344 B.R. 461, 464 (Bankr. W.D. Va. 2004)). As the Collier treatise puts it: "Even after the case is closed, the estate continues to retain its interest in unscheduled property." 5 COLLIER ON BANKRUPTCY ¶ 554.03 (Alan N. Resnick & Henry J. Sommer eds., 15th rev. ed. 2001).

Accordingly, the pivotal premise of the decision below – that the estate ceased to exist upon confirmation – conflicts with the Code, the COLLIER treatise, and the holdings of the Second and Eighth Circuits. Certiorari review is warranted.

D. The Decision Below Conflicts with Another Court of Appeals in Suggesting that Administrative Expenses Cannot Be Estimated.

As noted, the deductibles owed Zurich must be estimated because the claims have not been paid in full yet. *See supra* at 6, 8. Though terming the issue "non-dispositive," Pet. App. 44a, the district court's opinion, adopted by the Sixth Circuit, suggests that administrative expenses cannot be estimated because estimation is not expressly authorized by the Bankruptcy Code; therefore, the deductibles might not quali-

fy as administrative expenses. *Id.* at 44a-47a. The consequence of such a holding would be that any estimated administrative expense – contractual, environmental, or tort – must be disallowed. This cannot be, and is not, the law. Indeed, a sister court of appeals has explicitly approved estimation of administrative expenses. *Juniper Dev. Group v. Kahn (In re Hemingway Transp., Inc.)*, 993 F.2d 915, 934 (1st Cir. 1993).

Moreover, the Bankruptcy Code provides expressly that a claim properly includes amounts that are "unliquidated." 11 U.S.C. § 101(5). The term "actual" in section 503(b) does not mean that the amount of the liability has to be "liquidated" at any particular point to qualify as an administrative expense. The term "actual" means simply that the liability has to have been incurred by the debtor during the course of its bankruptcy case. In this matter, Horizon incurred the obligation to pay the full amount of its insurance when it signed up for it in 2001, including all deductible obligations. The fact Horizon was obligated to pay its deductible obligations over time, and that the precise amount of the payments were subject to change, does not make the obligations any less "actual." It simply makes them "unliquidated."

Further, the Code expressly authorizes debtors in chapter 11 to incur debts payable on credit over time. *Id.* §§ 363-64. It would make no sense to conclude that, having authorized debtors in bankruptcy to obtain goods and ser-

vices on credit, Congress secretly intended to deny payment to those same creditors who were not yet paid at the time the debtor confirmed its plan because their claims were not yet due or liquidated. The notion that an "actual" claim does not include an "unliquidated" claim is at war with the governing statutory scheme. Thus, to the extent that the decision below held that administrative expenses cannot be estimated, it created a circuit split with the First Circuit, *see Hemingway*, 993 F.2d at 934, and conflicts with the Code itself.

E. If Not Corrected, the Decision Below Will Have Grave Consequences for Reorganizations, Harming Debtors and Unfairly Denying Payment to Insurance and Other Service Providers.

As Zurich's petition demonstrates, the decision below, if not corrected, will have grave consequences for reorganizations. Absent reversal, it will permit debtors in bankruptcy to avoid paying for necessary insurance they purchase during the course of their cases. As a result, no insurer will be willing to provide insurance without demanding up-front payment or expensive forms of collateral to secure the debtors' obligations. Many debtors will thus not be able to obtain workers' compensation insurance, and because such insurance is required, they will not be able to reorganize, thwarting Congress's intent. *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513,

527 (1984) ("the policy of Chapter 11 is to permit successful rehabilitation of debtors").

CONCLUSION

For the foregoing reasons, Zurich's petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX
(Relevant Statutes)

Ky. Rev. Stat. § 342.340: Employer to insure or provide security against liability to workers; notification required

(1) Every employer under this chapter shall either insure and keep insured his liability for compensation hereunder in some corporation, association, or organization authorized to transact the business of workers' compensation insurance in this state or shall furnish to the executive director satisfactory proof of his financial ability to pay directly the compensation in the amount and manner and when due as provided for in this chapter. In the latter case, the executive director shall require the deposit of an acceptable security, indemnity, or bond to secure, to the extent the executive director directs, the payment of compensation liabilities as they are incurred. A public sector self-insured employer shall not be required to deposit funds as security, indemnity, or bond to secure the payment of liabilities under this chapter, if the public employer has authority to raise taxes, notwithstanding provisions of KRS 68.245, 132.023, 132.027, and 160.470 relating to recall and reconsideration of local taxes; raise tuition; issue bonds; raise fees or fares for services provided; or has other authority to generate funds for its operation.

(2) Every employer subject to this chapter shall file, or have filed on its behalf, with the office, as often as may be necessary, evidence of its compliance with the provisions of this section and all others relating hereto. Any insurance carrier or self-insured group providing workers' compensation insurance coverage for a Kentucky location shall file on behalf of the employer, with the executive director, evidence of the employer's compliance with this chapter. Evidence of compliance filed with the office may include a named additional insured who has been provided proof of workers' compensation insurance coverage by the employer. The filing shall be made within ten (10) days after the issuance of a policy, endorsement to a policy, or similar documentation of coverage. Every employer who has complied with the foregoing provision and has subsequently canceled its insurance or its membership in an approved self-insured group, as the case may be, shall immediately notify, or have notice given on its behalf to the office of the cancellation, the date thereof, and the reasons therefor; and every insurance carrier or self-insured group shall in like manner notify the executive director upon the cancellation, lapse, termination, expiration by reason of termination of policy period, or nonrenewal of any policy issued by it or termination of any membership agreement, whichever is applicable under the

provisions of this chapter, except that the carrier or self-insured group need not set forth its reasons therefor unless requested by the executive director. The above filings are to be made on the forms prescribed by the executive director. Termination of any policy of insurance issued under the provisions of this chapter shall take effect no greater than ten (10) days prior to the receipt of the notification by the executive director unless the employer has obtained other insurance and the executive director is notified of that fact by the insurer assuming the risk. Upon determination that any employer under this chapter has failed to comply with these provisions, the executive director shall promptly notify interested government agencies of this failure and, with particular reference to employers engaged in coal mining, the executive director shall promptly report any failures to the Department for Natural Resources so that appropriate action may be undertaken pursuant to KRS 351.175.

(3) The Office of Workers' Claims shall notify a named additional insured at the address listed on the evidence of coverage under a workers' compensation insurance policy upon the cancellation, lapse, termination, expiration, or nonrenewal of a workers' compensation insurance policy issued by the insurance carrier. The notice required in this subsection shall be

provided by the office no later than ten (10) days after the insurance notice is provided to the executive director as required in subsection (2) of this section.